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September 6, 2019

By Electronic Mail and First-Class Mail

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**Re: Puerto Rico Electric Power Authority – Supplemental Response to March 28, 2019
United States Environmental Protection Agency Notice of Potential Liability and
Request for Information**

Dear Ms. Leshak and Ms. Luna:

This letter and attachments are hereby submitted on behalf of the Puerto Rico Electric Power Authority (“PREPA”) in response to the United States Environmental Protection Agency’s (“EPA”) March 28, 2019 notice of potential liability and associated request for information pursuant to Sections 107(a) and 104(e) of the Comprehensive Environmental Response, Compensation, and Liability Act (“CERCLA”) (“March 28 Request” or the “Request”) in relation to the PROTECO Site located at Road 385, Km 4.4, Bo. Tallaboa, in Peñuelas, Puerto Rico (the “PROTECO Site” or the “Site”).

As confirmed by email communications dated April 5, 2019, between EPA and PREPA, the initial deadline for responding to EPA’s request was extended until May 24, 2019. EPA further agreed to limit the scope of several requests to facilitate PREPA’s timely response and to limit the collection of irrelevant information.¹ EPA also agreed that a partial response by May 24, 2019 would be acceptable provided it was not possible for PREPA to provide a complete response by that date.²

PREPA submitted an initial response to EPA’s requests on May 24, 2019 (“May 24 Response”). The responses below supplement PREPA’s May 24 Response with all additional information that PREPA has collected since it submitted the initial response. PREPA does not

¹ Email from Andrea Leshak, Office of Regional Counsel, U.S. EPA, to Hayley Fink, Hogan Lovells US LLP (May 9, 2019 13:28 EST) (on file with author).

² *Id.*

anticipate finding, collecting, or providing any further responses at this time. However if PREPA does locate additional relevant or responsive information, it will promptly supply it to EPA. PREPA is committed to ensuring that it provides EPA with all responsive information at the earliest possible opportunity.

Should EPA have additional questions regarding the information below or PREPA's involvement with the PROTECO site, PREPA would be happy to discuss further and can be reached through its attorneys at Hogan Lovells US LLP.

I. Objections and Qualifications

In view of the breadth of the March 28 Request, PREPA reiterates and incorporates by reference the general objections and qualifications to the Request first described in the May 24 Response.

II. Format of Response

Notwithstanding the foregoing, and without waiving any of the foregoing qualifications and objections, below PREPA has included the relevant numbered EPA request followed by PREPA's response. We have only included here those requests and responses for which we have supplemental information to provide. Whenever additional information or documents are referenced in a response to a request, such information and documents are expressly incorporated into the response, and identified as an appendix thereto. These documents are being sent via secure file transfer, with a folder labeled for each numbered request for which responsive documents are being produced. For instance, supplemental documents responsive to Request No. 9, will be in a folder titled "Supplemental Appendix 9."

The numbers of the responses below correspond to the numbers of the information requests included in EPA's Request.

III. PREPA's Supplemental Response to EPA's Information Request

Request No. 4:

Describe in detail the nature of the business and the operations conducted at the Facilities and at any location identified in response to Request #3, above, during the period that the Company operated there. Provide a brief description of the Company's operations at each facility including:

- a. The date such operations commenced and concluded; and
- b. The types of work performed at each facility, including but not limited to the industrial, chemical, or institutional processes and treatments undertaken at each facility.

Response to Request No. 4:

Subject to the general objections and qualifications set forth above PREPA responds as follows: Please see PREPA's May 24 Response. PREPA has not identified any additional responsive information.

Request No. 9:

Identify all individuals who had responsibility for the Company's environmental and waste management decisions between 1975 and 1999 (e.g., responsibility for decisions regarding the disposal, treatment, storage, recycling or sale of the Company's hazardous substances, hazardous wastes, and industrial wastes).

- a. Provide each individual's job title, duties, dates performing those duties, supervisors for those duties, current position, and if applicable, the date of the individual's resignation or termination.
- b. Provide the nature of the information possessed by each such individual concerning the Company's waste management.

Response to Request No. 9:

Subject to the general objections and qualifications set forth above PREPA responds as follows:

Below PREPA provides updated information related to individuals who had responsibility for PREPA's environmental and waste management decisions between 1975 and 1999, with the supplemental information relating to start and termination dates provided in **bold**. Please see Appendix 9 to PREPA's May 24 Response for job descriptions associated with the positions held by these personnel, which provide information regarding their duties and the nature of the information each individual would have possessed.

Individuals with responsibility for environmental matters at Costa Sur Power Plant:			
Name	Job Title	Start Date	Termination Date
Raul Rosado	Plant Head		
Pascual Ortiz	Plant Head	04/09/1972	04/14/2001
Benjamin Pagán	Chief Chemist	11/21/1978	07/14/2010
William Santiago	Chief Chemist	07/30/1972	01/18/2003
Hector Correa	Chief Chemist	08/06/1984	05/03/2010
Rosendo Vázquez	Environmental Advisor	03/25/1972	01/12/2011

Individuals with responsibility for environmental matters at Aguirre Power Complex:			
Name	Job Title	Start Date	Termination Date
Ivan Cora	Plant Head	08/07/1977	01/12/2008
Juan F. Alicea	Plant Head	06/15/1983	01/14/2009
Giovanni Rodriguez	Chemist Supervisor/ Environmental Advisor	09/05/1989	08/15/2016
Jaime Rodriguez	Chemist Supervisor	11/27/1980	04/15/2000
Leonardo Rodriguez	Chemist Supervisor/ Regulatory Compliance Supervisor	08/06/1988	07/15/2017

Angel Lugo	Chemist Supervisor/ Environmental Advisor	09/11/1978	03/24/2007
Biemvenido Rodriguez	Plant Head		

Individuals with responsibility for environmental matters at Palo Seco Power Plant:			
Name	Job Title	Start Date	Termination Date
Raul Ayala	Plant Head		
Josue Colon	Plant Head	01/03/1988	02/02/2013
Otto Garcia	Plant Head	06/15/1971	01/12/2008
Jaime Rosario	Chemist Supervisor	07/04/1971	07/02/1998
Moises Soto	Environmental Advisor	08/13/1972	03/31/2001

Individuals with responsibility for environmental matters at San Juan Power Plant:			
Name	Job Title	Start Date	Termination Date
Pedro Espina	Chief Chemist	05/27/1963	02/13/1993
Richard Concepción	Environmental Advisor	06/23/1980	07/15/2006

Request No. 13:

Identify, describe, and provide all documents that refer to or relate to the following:

- The nature, including the chemical content, characteristics, physical state (e.g. solid, liquid), and quantity (volume and weight) of all hazardous substances, hazardous wastes, and industrial wastes involved in each arrangement transferring materials from any facility owned or operated by the Company (including the Facility) to any other facility;
- In general terms, the nature and quantity of the non-hazardous substances involved in each such arrangement;
- The hazardous substances being mixed or combined with other hazardous substances or non-hazardous substances for each such arrangement. Indicate whether such mixing or combining is common in the industry. Indicate whether the Company was ever asked to stop mixing or combining the hazardous substances with the non-hazardous substances;
- Other materials other than the hazardous substances that were involved in the transaction;
- The condition of the transferred material containing hazardous substances when it was stored, disposed of, treated, or transported for disposal or treatment;

- f. The markings on and type, condition, and number of containers in which the hazardous materials were contained when they were stored, disposed, treated, or transported for disposal or treatment; and
- g. All tests, analyses, analytical results, and manifests concerning each hazardous substance, hazardous waste, and industrial waste involved in each transaction. Include information regarding who conducted the test and how the test was conducted (batch sampling, representative sampling, splits, composite, etc.).

Response to Request No. 13:

Subject to the general objections and qualifications set forth above PREPA responds as follows:

Please see PREPA's May 24 Response. Supplemental Appendix 13 contains additional documents related to waste characterization. See Bates 004303-004309.

Request No. 18:

Please provide copies of the Company's financial statements, shareholder's reports, financial audits, or other financial reports showing its assets, profits, liabilities, and current financial status for the last five years.

Response to Request No. 18:

Subject to the general objections and qualifications set forth above PREPA responds as follows:

Please see PREPA's May 24 Response. Supplemental Appendix 18 contains PREPA's financial statement for the fiscal year ending June 30, 2017. See Bates 004310-004416.

The certification requested in the March 28 Request and supplied in PREPA's May 24 Response is incorporated as part of this supplement.

PREPA stands willing to discuss the foregoing responses and its appendices with EPA at a mutually convenient time

Respectfully submitted,



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Ms. Andrea Leshak
Ms. Zolymar Luna

September 6, 2019

Enclosures

AUTORIDAD DE ENERGIA ELECTRICA DE PUERTO RICO

SAN JUAN, PUERTO RICO

150900



DIRECCION CABLEGRAFICA
PREPA
DIRECCION TELEX AC
385714

APARTADO 4267
CORREO GENERAL
SAN JUAN, PUERTO RICO 00935

30 de julio de 1981

RECEIVED
PREPA
31 JUL
JUL 30 1981

Envi on e il Programs
Department

MEMORANDO

A : Sr. Raúl McClin
Supervisor
Depart a mento Pro gramas Ambientales

DE : Roberto Rosado *RR*
Supervisor
Laboratorio Control Contaminación

ASUNTO : Pruebas de Toxicidad de desperdicios
de Plantas de Tratamiento

Durante los días 20 y 21 de julio de 1981 se llevaron a cabo pruebas de toxicidad de muestras de desperdicios sólidos de las Plantas de Tratamiento de Aguirre, Costa Sur, Palo Seco y San Juan.

El propósito de estas pruebas fue el de determinar si se podía disponer odecua-
damente de los desperdicios de acuerdo con las normas de la EPA.

Estas muestras fueron tomadas por los químicos de las distintas Plantas entre el 25
de junio y el 14 de julio de 1981.

A continuación los resultados obtenidos en ppm:

A) Metales Pesados requeridos en la prueba

Planta	Metal Cd	Cd*	Cr	Cr*	Pb	Pb*	Hn	Hg*	Ba	Ba*
ASP	0.029	1.0	<0.005	5.0	0.023	5.0	<0.030	0.2	2.8	100
SCSP	0.024	"	<0.005	"	0.044	"	<0.030	"	1.4	"
PSSP	0.009	"	<0.005	"	0.030	"	0.039	"	0.3	"
SJSP	0.009	"	<0.005	"	0.058	"	0.047	"	0.3	"

* - Concentración máxima permitida en ppm.

B) Otros análisis de estas muestras:

M E T A L

Planta	Al	C	Co	Cu	Fe	Mg	Ni	P	S	Si	V	Zn
ASP	2.15	7128	354.8	0.496	2.24	94.5	61.0	0	176.4	29.3	0.06	2.40
SCSP	2.64	7422	347.3	12.92	0.26	101.9	119.4	0	374.0	41.0	0.04	8.76
PSSP	3.08	2360	56.3	0.388	313.07	55.7	65.7	0.05	467.4	23.3	0.006	3.05
SJSP	0.51	2772	40.4	0.628	239.1	30.7	62.4	0	552.3	24.4	0	3.06

Anotaciones:

1. Todos los análisis, a excepción del Bario, se hicieron usando el ICP (espectrómetro de argón plasma). El Bario se analizó por absorción atómica.
2. No se hizo análisis de As, Se y Ag (requeridos en la prueba de toxicidad) debido a que no contamos con estos elementos en el instrumento.
3. Durante la prueba se requiere que se ajuste el pH a 5.0 ± 0.2 por 24 horas usando ácido acético.

Se notó que las muestras de Palo Seco y San Juan no mantuvieron este pH una vez se ajustó. El pH de estas muestras continuó bajando hasta 4.2.

Los resultados del análisis de Fe de estas dos muestras es de 239 y 313 ppm comparando con 0.26 y 2.24 ppm de Aguirre y Costa Sur.

Después de guardar estas dos muestras por varios días se empezó a precipitar el Fe en las botellas. Las otras dos permanecieron transparentes.

Conclusiones:

1. A pesar de que no se hicieron los análisis de Arsénico, Selenio y Plata, los resultados obtenidos en los demás metales pesados indican que se puede disponer adecuadamente de estos desperdicios cumpliendo con las normas requeridas. Los resultados obtenidos en estos metales está muy por debajo de los límites requeridos por la EPA.

RR/mmm

SAN JUAN, PUERTO RICO



DIRECCION CABLEGRAFICA
PREPA
DIRECCION TCLEX AC
385744

150903



APARTADO 4267
CORREO GENERAL
SAN JUAN, PUERTO RICO 00936

20 de octubre de 1981

A : Roberto Rospdo
Supervisor Laboratorio Ambiental
De : Michael Morris
Químico Ambiental

Asunto : Pruebas realizadas al cieno de las pocetas de descarga de las
Plantas de tratamiento de SJSP, PSSP, SCSP, y ASP.

Durante el período del 5 al 14 de agosto de 1981, fueron analizados los desperdicios (cieno) de las pocetas de las plantas de tratamiento de las centrales San Juan, Pclo Seco, Costa Sur y Aguirre.

Las pruebas realizadas fueron: Corrosividad, pH y Reactividad.

Estas pruebas fueron hechas según el método descrito en NACE Standard TM-01-69, revisión de 1976, bajo el título de "Laboratory Corrosion Testing of Metals for the Process Industries", y basándonos en las regulaciones descritas en: "Federal Register/Vol. 45, No. 98/ Monday, May 19, 1980/ Rules and Regulations; p.33122, 261.22 .

A continuación los datos obtenidos: (Ver tablas I y II adjuntas).

Resumen:

a) Las muestras de cieno de los diferentes centrales fueron analizadas tomando 500 g de muestra en 1800 ml de agua destilada en un envase sellado, equipado con condensador. Se colocó una placa de acero previamente pesada en el cieno, y otra en el agua. Se mantuvo a 55°C en un baño a temperatura constante por siete (7) días. Luego fueron limpiadas, pesados, y observadas. Se observaron a simple vista, a través de cristal de aumento, y a través de un microscopio. Un resumen de los resultados visuales se encuentra en la tabla II.

b) Se calculó la razón de corrosividad mediante la pérdida de peso

en los plocas y utilizando la siguiente fórmula:³

$$\text{mmpy} = \frac{\text{wt. loss} \times 87.6}{(\text{area}) (\text{time}) (\text{metal dens.})}$$

Donde:

- wt. loss es la pérdida en peso de las placas en miligramos.
- area es centímetros cuadrados de metal expuesto (25).
- time es horas expuestas (168)
- metal dens. es la densidad del metal (7.86g/cc)
- mmpy es milímetros por año

NOTAS:

1. National Association of Corrosion Engineers.
2. Microscopio "FORTY" , American Optical.
3. Tomada de NACE Standard TM-01-69 (1976 Revision), Test Method, Laboratory Corrosion Testing of Metals for the Process Industries.

CONCLUSION:

En base a las especificaciones del Federal Register, estas muestras de cieno están muy por debajo de los límites, ya que la corrosividad debe ser no mayor de 6.35 mmpy, el pH debe estar entre 2.0 y 12.5. Además todas las muestras resultan negativas a todas las especificaciones de reactividad.

Se concluye por estas razones, que estas muestras están aceptables.

TABLA I

PRUEBA	Muestra SJSP		Muestra PSSP		Muestra SCSP		Muestra ASP		Bianco
	Cieno	Agua	Cieno	Agua	Cieno	Agua	Cieno	Agua	Agua destilado
pH *	5.6	5.6	7.7	7.7	8.1	8.1	8.5	8.5	5.5
Corrosividad **	0.196	0.229	0.073	0.252	0.132	0.172	0.006	0.097	0.239
Reactividad ***	Neg.	Neg.	Neg.	Neg.	Neg.	Neg.	Neg.	Neg.	Neg.

*De la solución resultante

**En mmpy

***Según Federal Register/Vol. 45, No. 98/Monday, May 19, 1980
p.33122

004307

TABLA II

PRUEBA	Muestra SJSP		Muestra PSSP		Muestra SCSP		Muestra ASP		Bianco
	Cieno	Agua	Cieno	Agua	Cieno	Agua	Cieno	Agua	Agua destilada
SIMPLE VISTA									
Superficie	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme
Porosidad	negativo	poca	negativo	negativo	negativo	negativo	negativo	negativo	negativo
LENTE AUMENTO									
Superficie	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme
Porosidad	area 20%	area 20%	negative	poca	area 50%	Area 70%	negativa	poca	negativo
MICROSCOPIO									
Superficie	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme	uniforme
Porosidad	0.1mm	0.5mm	poca	poca	poca	0.5mm	poca	poca	poca

20 de octubre de 1981

ANALISIS METALICO CIENO PLANTAS TRATAMIENTO

FASE LIQUIDA DEL CIENO

Centrol	Al	Co	Cl	Cr	Cu	Fe	Hg	Mg	Mn	Na	Ni	P	Pb	Sb	Si	V	Z
an Juan	3,54	104	0.02	0.03	0.75	0.91	0.002	61	123	765	27.4	0.32	0.25	0.07	30.20	0.06	0.4
olo Seco	2.31	134	0.01	0.03	0.01	0.35	0.002	105	5.34	1,420	5.75	0.38	0.11	0.06	3.32	0.02	0.0
osta Sur	5.34	259	0.01	0.05	0.01	0.05	0.002	129	0.06	7,836	0.31	0.86	0.13	0.09	2.85	0.41	0.0
guirre	0.56	33.5	0.01	0.03	0.02	0.09	0.002	66	0.06	2,379	0.09	0.37	0.07	0.05	2.73	0.60	0.0

FASE SOLIDA DEL CIENO

an Juan	0.24%	0.13%	7.0	743	808	9.1%	0.01	0.06%	316	0.46%	0.29%	2,081	217	162	177	1.2%	1
alo Seco	1.10%	0.29%	21.6	957	1,058	22.8%	0.01	0.56%	1,542	1.24%	1.51%	1,756	372	196	328	5.2%	9
osta Sur	0.83%	1.72%	20.9	1,678	3,849	25.8%	0.01	0.58%	1,963	0.21%	1.54%	2,112	439	200	359	3.4%	1,6
guirre	2.00%	3.96%	13.3	709	1,255	16.9%	0.01	1.71%	1,589	1.65%	0.73%	1,737	221	153	588	1.7%	1,8

Nota: Concentraciones dados en ppm, excepto cuando se indique %.

MJM/HMA/ara

PUERTO RICO ELECTRIC POWER AUTHORITY
(A COMPONENT UNIT OF THE COMMONWEALTH OF PUERTO RICO)

INDEPENDENT AUDITORS' REPORT
AUDITED FINANCIAL STATEMENTS,
REQUIRED SUPPLEMENTARY INFORMATION
AND
SUPPLEMENTAL SCHEDULES

For the year ended June 30, 2017

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(A Component Unit of the Commonwealth of Puerto Rico)
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INDEPENDENT AUDITORS' REPORT

To the Governing Board of the
Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico):

Report on the Financial Statements

We have audited the accompanying financial statements of Puerto Rico Electric Power Authority (A Component Unit of the Commonwealth of Puerto Rico) (the "Authority"), as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the Authority's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in conformity with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of PREPA Holdings, LLC (a blended component unit), which represent 0.7 percent, 0.4 percent, and 0.1 percent, respectively, of the assets, net position (deficit), and revenues of the Authority. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for PREPA Holdings, LLC, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

BDO, Puerto Rico, PSC, a Puerto Rico Professional Services Corporation; and BDO USVI, LLC, a United States Virgin Island's limited liability company, are members of BDO International Limited, a UK company limited by guarantee, and form part of the international BDO network of independent member firms.

BDO is the brand name for the BDO network and for each of the BDO Member.



To the Governing Board of the
Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)
Page 2

Opinion

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the financial position of the Puerto Rico Electric Power Authority as of June 30, 2017, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Other Matters

Emphasis of Matter Regarding Uncertainty About Ability to Continue as a Going Concern

The accompanying basic financial statements have been prepared assuming that the Authority will continue as a going concern. As discussed in Note 3 to the financial statements, the Authority has an accumulated deficit of approximately \$6 billion as of June 30, 2017, and during the year ended June 30, 2017, the deficit increased by approximately \$1.3 billion. Also, as disclosed in Notes 3, 7 and 12, due to liquidity constraints, during the year ended June 30, 2017, the Authority did not make the required deposits to the Sinking Fund, payments to current fuel lines of credit, notes payable and the complete portion of the required employer contribution to the Puerto Rico Electric Power Authority Employee Retirement System. As discussed in Note 19 to the financial statements, on July 2, 2017 the Financial Oversight and Management Board filed petition on behalf of the Authority for relief under Title III of the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"). These matters raise substantial doubt about the Authority's ability to continue as a going concern. Note 3 discloses management's evaluation of the events and conditions and plans regarding these matters. The financial statements do not include any adjustments that might result from the outcome of this uncertainty. Our opinion is not modified with respect to these matters.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 4 through 13 and the Supplementary Schedule of Funding Progress-Postemployment Health Plan, Schedule of Changes in the Authority's Net Pension Liability and Related Ratios and Schedule of Employer Contributions - Pension Plan on pages 94 through 97, respectively, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We and other auditors have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.



To the Governing Board of the
Puerto Rico Electric Power Authority
(A Component Unit of the Commonwealth of Puerto Rico)
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Other Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The supplemental schedules on pages 99 to 103 are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information are the responsibility of management and were derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. We have applied certain limited procedures to the supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

BDO Puerto Rico, PSC.

San Juan, Puerto Rico

June 28, 2019

Certified Public Accountants
(of Puerto Rico)

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PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2017

Introduction

This section of the financial report presents the analysis of the Authority's financial performance for the fiscal years ended June 30, 2017 and 2016. We recommend readers to consider the information herein presented in conjunction with the financial statements and the notes to the financial statements that follow this section.

Required Financial Statements

The financial statements provide an indication of the financial health of the Authority. The Statement of Net Position (Deficit) presents all the assets, deferred outflows of resources, liabilities, deferred inflows of resources and net position (deficit) at year-end. The Statement of Revenues, Expenses and Changes in Net Position (Deficit) presents all the revenues and expenses of the year and information as to how net position or deficit changed during the year. The Statement of Cash Flows shows changes in cash and cash equivalents, resulting from cash received and paid for operating activities, non-capital financing activities, capital financing activities, and investing activities. The notes to the financial statements provide information required and necessary to the understanding of material information of the financial statements.

Financial Analysis

The Authority's condensed Statements of Net Position (Deficit) as of June 30, 2017 and 2016, were as follows (2016 are presented without the effects of the restatement disclosed in Note 4) (in thousands):

	June 30,	
	2017	2016
Assets and Deferred Outflows		
Current assets	\$ 1,600,658	\$ 1,454,319
Non-current assets	64,463	135,117
Capital assets	<u>6,296,982</u>	<u>6,702,210</u>
Total assets	7,962,103	8,291,646
Deferred outflows of resources	<u>1,630,869</u>	<u>1,299,024</u>
Total assets and deferred outflows of resources	<u>9,592,972</u>	<u>9,590,670</u>
Liabilities, Deferred Inflows and Net Position (Deficit)		
Current liabilities	2,638,426	2,146,724
Long-term debt	7,792,301	8,143,318
Other non-current liabilities	<u>5,243,495</u>	<u>4,068,034</u>
Total liabilities	15,674,222	14,358,076
Deferred inflows of resources	<u>59,319</u>	<u>70,660</u>
Total liabilities and deferred inflows of resources	<u>15,733,541</u>	<u>14,428,736</u>
Net position (deficit):		
Net investment in capital assets	(2,075,907)	(1,328,918)
Deficit	<u>(4,064,662)</u>	<u>(3,509,148)</u>
Total net position (deficit)	<u>\$ (6,140,569)</u>	<u>\$ (4,838,066)</u>

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2017 Compared to 2016

As of June 30, 2017 and 2016, the Authority's total assets amounted to \$8.0 billion and \$8.3 billion, respectively, which reflect a decrease of \$330 million (4 percent decrease). The net decrease in total assets is mainly due to the net effect of the following:

- An increase of \$152.2 million in cash and cash equivalents. On June 30, 2016, the Authority paid \$195 million in interest and \$224 million principal related to bonds payable, due on July 1, 2016. Also, on June 30, 2016, the Authority received \$295.4 million in bond proceeds. On June 30, 2017, compared to the prior year, the Authority did not make the long term debt payments due on July 1, 2017, increasing the cash and cash equivalents balances as of June 30, 2017.
- A decrease of \$405.2 million in capital assets, mainly due to an increase in accumulated depreciation of \$519.9, additions of \$168.4 million to construction work in process and a decrease of \$59.8 million related to a restatement in beginning balance (as disclosed on Note 4).
- A decrease of \$95 million in accounts receivables, mainly due to a decrease of \$148 million in government net account receivable balances due to an increase in payments received from the Commonwealth. In addition, there was an increase of \$81.9 million in general client net accounts receivable, and a decrease in bonds proceeds receivable of \$23.6 million upon the receipt of 2016 bond issuance proceeds, series C, D, and E.
- An increase of \$33.4 million in fuel inventory, caused by an increase of \$13 million due to an increase in the average price of \$7.57 per fuel barrel, and an increase of \$20.4 million, due to a decrease in fuel consumption during the year.

As of June 30, 2017 and 2016, the Authority's total liabilities amounted to \$15.7 billion and \$14.4 billion, respectively, for an increase of \$1.3 billion (9 percent). The increase in total liabilities is mainly due to the net effect of the following:

- An increase in net pension liability by \$1.1 billion, due to a change in actuarial assumptions and methods.
- An increase in accrued interest of \$217.7 million related to long term debt bond interest payments due on July 1, 2017. On June 30, 2016, the Authority paid \$195 million for interest due on July 1, 2016.

The largest portion of the Authority's net position (deficit) is the deficit of \$4.1 billion. The net position consists of the differences of assets and deferred outflows over(under) related liabilities, and deferred inflows that are neither externally legally restricted, nor invested in capital assets. This deficit is substantially the continued increase in the net pension liability, combined with the revenue shortfalls and the payment of expenses in excess of anticipated amounts, such as compensated absences, claims and judgments, and others.

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An additional portion of the Authority's net position (deficit) represents a negative \$2.1 billion net investment in capital assets such as land, infrastructure, buildings, equipment, among others, less any outstanding related debt used to acquire those assets. This negative balance results from the combined refinancing of capital related debt, while capital assets continue to depreciate.

The Authority's condensed Statements of Revenues, Expenses and Changes in Net Position (Deficit) for the years ended in June 30, 2017 and 2016, were as follows (2016 are presented without the effects of the restatement disclosed in Note 4) (in thousands):

	Year Ended June 30,	
	2017	2016
Revenues:		
Operating revenues	\$ 3,298,223	\$ 2,994,893
Non-operating revenues	37,117	44,315
Total revenues	3,335,340	3,039,208
Operating expenses:		
Fuel	1,217,525	1,215,312
Purchased power	728,872	687,212
Depreciation	519,406	517,202
Maintenance	355,844	317,061
Transmission and distribution	354,563	282,656
Administrative and general	322,475	315,758
Customer accounting and collection	242,898	179,537
Other production	118,570	146,128
Total operating expenses	3,860,153	3,660,866
Non-operating expenses:		
Interest expense on bonds	430,652	415,461
Interest expense on notes payable and other long-term debt	53,736	53,956
Amortization of debt premium/(discount), issuance costs and refunding loss	(1,531)	7,699
Allowance for funds used during construction	-	(2,833)
Total non-operating expenses	482,857	474,283
Total expenses	4,343,010	4,135,149
Loss before contribution in lieu of taxes and capital contributions	(1,007,670)	(1,095,941)
Contribution in lieu of taxes	(178,003)	(172,467)
Capital contributions	7,317	8,243
Change in net position (deficit)	(1,178,356)	(1,260,165)
Net position (deficit) at beginning of year	(4,838,066)	(4,054,940)
Correction of errors	(124,147)	477,039
Net position (deficit) at beginning of year, as restated for 2016	(4,962,213)	(3,577,901)
Net position (deficit) at end of year	\$ (6,140,569)	\$ (4,838,066)

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2017 compared to 2016

The Authority's total revenues increased by approximately \$296 million, representing a 10 percent increase for the year ended June 30, 2017. Operating revenues are from energy sales, where the Authority charges each client for the services provided plus the costs of the fuel and energy purchased to provide those services (fuel and energy adjustment clauses). The increase in total revenues is mainly due to the net effect of the following:

- The implementation of the provisional rate on August 1, 2016, which increased by \$0.1299 each kilowatt hour ("Kwh") billed during the cycle period of all clients. For the year ended June 30, 2017, the provisional rate represented \$199 million increase in operating revenues.
- An increase in revenue of \$57.5 million caused by a decrease in the bad debt expense. During the year ended June 30, 2017, the decrease in bad debt expense is because the Authority changed its methodology of the estimated allowance for uncollectible accounts.
- A decrease in the revenues derived from the basic tariff for the amount of \$26.9 million, caused by a 2% decrease in energy sold to clients from 17,349 MkwH to 16,996 MkwH for the years ended June 30, 2016 and June 30, 2017 respectively.
- During the year ended June 30, 2017, the costs of fuel and energy were \$1,946 million, and for the year ended June 30, 2016 were \$1,903 million, causing an increase of approximately of \$43 million in the amounts billed to clients.

The Authority's total expenses amounted to \$4,343 million and \$4,135 million for the years ended June 30, 2017 and 2016, respectively, representing an increase of \$208 million or 5 percent. The increase in total expenses is due to an increase in operating expenses of \$199 million or 5 percent, and an increase in non-operating expenses of \$8.6 million or 2 percent. The increase in operating expense is mainly due the net effect of the following:

- An increase in the Authority's purchased power. During the year ended June 30, 2017, the Authority's purchase power expense was \$729 million, when compared with the year ended June 30, 2016, which was \$687 million, representing an increase of approximately \$42 million or 6 percent. The reason for the increase in purchased power is that during the year June 30, 2017, the Authority purchased 400.23 MkwH more, when compared to the year ended June 30, 2016, at an average cost of \$0.1049 per Kwh. The reason for the increase in the purchase power of the 400.23 MkwH is due to that, during the year ended June 30, 2016 there was an extended maintenance of the AES 2 unit in Guayama, which were out of service from October 1, 2015 until December 18, 2015. The AES unit began operations after December 18, 2015. During the year ended June 30, 2017, the AES 2 unit operated for the whole year, when compared to the prior year, which only operated for the second semester of the year, causing this increase of \$42 million in the purchase power expense.

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- An increase in the maintenance expense of \$38.8 million, mainly due to an increase in pension expense of \$67.3 million, a decrease in materials expense of \$22.7 million and a decrease in salaries of \$4.6 million that are allocated to this division. The increase in pension expense is directly related to annual calculation of pension cost by the Authority's actuaries. The decrease in materials expense is caused by the implementation of a new methodology to estimate the allowance for material inventory obsolescence during the year ended June 30, 2016, which caused an increase of \$57.8 million. During the year ended June 30, 2017, there were no changes in the estimate of the materials inventory obsolescence allowance.
- An increase in the transmission and distribution expense of \$71.9 million, mainly due to an increase in pension expense of \$88.7 million that are allocated to this division, a decrease in materials expense of \$16.7 million mainly caused by the impact of the obsolescence allowance recognized during the year ended June 30, 2016.
- An increase in customer accounting and collection expenses of \$63.4 million, which is mainly related to an increase in pension expense of \$65.5 million that are allocated to this division and a decrease in materials expense of \$4.4 million caused by the impact of the obsolescence allowance recognized during the year ended June 30, 2016.
- A decrease of other production expense of \$27.6 million, which is mainly caused due to an increase in pension expense of \$19.7 million that are allocated to this division, a decrease in material expenses of \$13.8 million caused by the impact of the obsolescence allowance recognized during the year ended June 30, 2016, and a decrease of \$34.2 million because of the impact of the impairment of capital assets recorded on prior year financial statements.

The increase in non-operating expenses of \$8.6 million is mostly due to an increase in bond interest expense of \$15.2 million and a decrease of \$9.2 million related to debt discount, premium and refunding loss amortization expenses.

Capital Assets and Debt Administration

Capital Assets

Capital assets as of June 30, 2017 and 2016, amounted to approximately \$6,297 million, and \$6,642 million respectively. The Authority's net investment in capital assets decreased by \$345 million or 5 percent (after restatement), as a result of having depreciation expense of approximately \$519 million, net of additions of approximately \$172 million for the year ended June 30, 2017.

Capital assets as of July 1, 2016, were restated by approximately \$59.8 million because the Authority corrected errors in the balances of depreciable and non-depreciable capital assets and the accumulated depreciation.

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Major capital assets projects undertaken by Authority during the year ended June 30, 2017 included the following:

- An Investment of approximately \$2.4 million in water infrastructure projects to comply with the National Pollutant Discharge Elimination System permits at San Juan Power Plant and Aguirre Power Complex. The integration of advanced water treatment technologies for reusing processed wastewater will benefit the surrounding environment and reduce the processed water with the exception of the non-contact cooling water discharge. In addition, the Aguirre Water Supply Project replaced the underground water extraction from Southern Aquifer. This project was completed in October 2018.
- The reconstruction and rehabilitation of 115 kV and 38 kV circuit lines, which include the reconstruction of 42 miles 115 kV transmission line (36100) interconnecting the Bayamón Transmission Center ("TC"), Cana 115 kV switchyard, Barrio Piñas 115 kV switchyard, Dos Bocas Hydroelectric Plant, and important substations in the municipalities of Bayamón, Toa Baja, Toa Alta, Corozal, Morovis and Ciales. This project consists of seven phases, of which the first two have been completed and are in service. The third phase is the reconstruction of 6.5 miles of 115 kV transmission line with a 1,192.5 kcmil ACSR conductor from Bayamón TC to the Cana TC. The fourth through seventh phases are scheduled for future years. During the fiscal year ended June 30, 2017, the total capital expenditures related to the reconstruction of transmission line 36100 were \$3.9 million. The reconstruction and rehabilitation of four 115 kV transmission lines interconnecting the Palo Seco power plant with relevant 115/38 kV transmission centers located in the metropolitan area are also included, with an expected in service date during the fiscal year ending June 30, 2022. Subtransmission circuits interconnecting substations in the municipalities of Orocovis, Barranquitas, Comerío, Arecibo, Utuado, San Sebastián, Lares, Maricao, Las Marías and Mayagüez, located in the central and west regions of the Island, are also part of this major reconstruction and rehabilitation plan.
- There were two air insulated 115/38 kV transmission centers under construction in the municipalities of San Juan and Caguas. Investment in this project during the year ended June 30, 2017, amounted to approximately \$4.3 million. The Buen Pastor Transmission Center in San Juan will improve the reliability of the commercial and industrial loads in Río Piedras under contingency situations in the southern metropolitan area. The Bairoa Transmission Center in Caguas, which is expected to be completed in June 2019, will significantly improve the reliability at Caguas and nearby municipalities, by providing backup to 115/38 kV transformer contingencies located at the Caguas Transmission Center.
- During the year ended June 30, 2017, the Authority invested \$6 million in new technology equipment as part of a plan to relocate the corporate data center. The updated data center will ensure the Authority has the most up-to-date security measures in place to protect its data. The project is expected to be completed at the end of 2019.

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- During the year ended June 30, 2017, the Authority also invested \$7.6 million in the acquisition and installation of intelligent meters on residential customers. These meters automatically capture information about electricity consumption and then transmit it back to the Authority. Intelligent meters can provide accurate measurements of electricity use while eliminating the need home visits from meter readers. This investment is a necessary step for the Authority's overall plan on renewal energy for the island. The investment is part of a second stage of the project to reach to the goal of installing intelligent meters to 45 thousand residential customers. This project is expected to be completed at the end of 2019.
- During the year ended June 30, 2017, the Authority invested \$14.3 million in the rehabilitation of the Central San Juan combined cycle units 5 and 6, which included the replacement of critical parts enhancing their useful life. The rehabilitation was completed on September 2018. Other significant rehabilitation projects included the investment of \$15.3 million during the year ended on June 30, 2017, on the rehab of the Central Mayaguez's aero-derivate turbines and the improvement of the Central Aguirre's turbo-generator.

Additional information on the Authority's capital assets can be found in Note 8 to the financial statements.

Long-Term Debt

At June 30, 2017 and 2016, the Authority had total notes and bonds payable outstanding of \$8,969.1 million and \$9,118.2 million, respectively. The Authority did not make the required deposits to the Sinking Fund as a result of the financial liquidity limitations.

As of June 28, 2019, the Authority's bonds were rated "Ca" by Moody's, "NR" by S&P and "D" by Fitch.

In March 2017, the Authority received approximately \$4.6 million from the revolving line of credit of \$27 million to finance improvements to the Aguirre Power Complex Water Supply and Waste Water Treatment Plan Improvement Revolving Loan, with maturity date in September 2033 and an effective interest of 2%. The loan increase amount was made to the Authority as a reimbursement for cost incurred in the project during prior and current fiscal years.

On February 28, 2008, PREPA Net entered into a note payable agreement with a commercial bank of approximately \$10.1 million. The note payable bears interest at U.S. prime rate plus .50% (4.75% as of June 30, 2017) and with maturity date in February 2023. Outstanding balance as of June 30, 2017 is \$245 thousand. PREPA Net paid off the outstanding balance in November 2017.

As disclosed in Note 19, approximately \$8,996 million of notes and bonds payable subject to compromise, arising from the proceedings under Title III of PROMESA.

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See additional information in Notes 10 to 11 to the financial statements.

Currently Known Facts or Conditions That May Have a Significant Effect on the Authority's Financial Condition or Results of Operations

The Authority's Governing Board and Management

On June 26, 2017, the Governor signed into law Act No. 37 of 2017 ("Act 37-2017") changing the composition of the Authority's Governing Board (the "Governing Board"), which will consists of seven members, six members are designated by the Governor (three of which require Senate approval) and one member will be an elected consumer representative.

PROMESA

On June 30, 2016, the President of the United States signed into law the Puerto Rico Oversight, Management, and Economic Stability Act ("PROMESA"). In general terms, PROMESA seeks to provide the Commonwealth with fiscal and economic discipline through, among other things: (i) the establishment of the Financial Oversight and Management Board, whose responsibilities include the certification of fiscal plans and budgets for the Commonwealth and its component units; (ii) a temporary stay of all creditor lawsuits; and (iii) two alternative methods to adjust unsustainable debt: (a) a voluntary debt modification process under Title VI of PROMESA, which establishes a largely out of court debt restructuring process through which modifications to financial debt can be accepted by a supermajority of creditors; and (b) a quasi-bankruptcy proceeding under Title III of PROMESA, which establishes an in court debt restructuring process substantially based upon incorporated provisions of the U.S. Bankruptcy Code.

Oversight Board Commencement of Title III Case

As disclosed in Note 19, on July 2, 2017, the Financial Oversight and Management Board filed a petition for relief under Title III of PROMESA. All of the Title III cases of Puerto Rico have been consolidated for procedural purposes only and are being jointly administered in the United States District Court for the District of Puerto Rico. Title III of PROMESA incorporates the automatic stay provisions of US Bankruptcy Code, which are made applicable to the Title III cases pursuant to PROMESA section 301(a).

Proposed Sale of Assets of the Authority

On January 22, 2018, the Governor announced the transformation of the Authority in order to enhance and improve the Authority's operations. The transformation will involve; (a) private ownership and operation of certain generation assets and (b) an operator of the transmission and distribution system through a concession model. On June 20, 2018, the Governor signed Act 120, which establishes a legal framework for the disposition, transfer and sale of the Authority's assets, operations, functions and services. On October 31, 2018, the Governor announced the request for qualifications from interested entities, for the administration and operation of all transmission and distributions activities of the Authority, through an arrangement of a public-private partnership contract. The Authority is currently in the process of evaluating the qualification submission from interested entities.

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Act 120-2018 - Puerto Rico Electric System Transformation Act

Act No. 120-2018 authorized the required legal framework for the transformation of the Authority via a series of Public-Private Partnerships, to be made in accordance with the framework set forth in the Public-Private Partnership Act of 2009. The Act allows for the sale of assets related to generation and the transfer or delegation of any of PREPA's operations, functions or services. The Act modifies the existing regulatory structure and establishes a working group to design a new regulatory framework and energy public policy for a private sector-based energy system

Act 17-2019 - Puerto Rico Energy Public Policy Act

On April 11, 2019 the Governor signed Act 17-2019 to establish public policy and the regulatory framework for Puerto Rico's energy sector and sets the path for its transformation.

Financial Condition and Liquidity

For a discussion of facts and conditions related to the Authority's liquidity that will have a significant effect on the Authority's financial condition and operations, see Note 3 to the financial statements.

Subsequent Events

The most significant subsequent events are the following:

- Permanent rate - The Provisional Rate came into effect in the first billing cycle of August 2016 and was to be effective until the implementation of a Permanent Rate. Through resolution and Order of November 27, 2018, the Puerto Rico Energy Bureau (formerly known as the Puerto Rico Energy Commission) has ordered the Authority to implement the Permanent Rate on May 1, 2019.
- Hurricane Irma's Impact on Customer Power Grid- On September 5, 2017, the Authority declared an emergency to address expected operational challenges due to Hurricane Irma approaching Puerto Rico. On September 6, 2017, Hurricane Irma passed just north of San Juan, Puerto Rico as a Category 5 hurricane.
- Hurricane María's Impact on Power Grid- As a result of Hurricane María, power outages reached its highest point on September 20, 2017 with 1.4 million (or 100 percent) of customers without power. The Authority is still assessing the extent of damages and quantifying the costs of repairing and rebuilding the system. Additionally, the Authority is working closely with FEMA to ensure adequate documentation of the costs of the emergency and repairs. The Authority has submitted and is currently working in a property insurance claim to its insurers.

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- Hurricanes Irma and María Impact on Electric System and Grid - the Authority's electric system and grid sustained significant damage as a result of Hurricanes Irma and Maria. The Authority requested FEMA and other critical stakeholders to be present at the Authority's headquarters on a regular basis to be part of an integrated working group to expedite execution of the Authority's emergency response plan. On August 14, 2018, the Authority announced it completed the restoration of power to all its clients.
- 2018 Preliminary Restructuring Support Agreement- On July 30, 2018, (i) the Authority, (ii) the AAFAF in its capacity as fiscal agent and financial advisor the Authority, (iii) the Financial Oversight and Management Board for Puerto Rico ("FOMB") and (iv) members of the Ad Hoc Group of the Authority's Bondholders (collectively the "Ad Hoc Group"), entered into a preliminary restructuring support agreement (the "RSA") and associated term sheet (the "Term Sheet"). On May 3, 2019, the Governor of Puerto Rico announced that the FOMB, Puerto Rico Fiscal Agency and Financial Advisory Authority ("AAFAF," for its Spanish acronym), and the Authority, reached a Definitive Restructuring Agreement ("Agreement") with a substantial portion of the Authority's bondholders. Under the Agreement, the bondholders will exchange their existing PREPA bonds for two types of new securitization bonds. The terms of the Agreement require the approval of legislation in the Legislative Assembly of Puerto Rico and will be subject to the approval of the Federal Court in the judicial process of PREPA under Title III of PROMESA.

For a detail discussion of these and other subsequent events that may have a significant effect on the Authority's financial condition and operations, see Note 19 to the financial statements.

Request for Information

This financial report is designed to provide a general overview of the Authority's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Authority's Chief Financial Officer. The executive offices of the Authority are located at 1110 Ponce de León Avenue, San Juan, Puerto Rico 00907. Other financial information can be obtained the Authority's official web page www.aeepr.com.

PUERTO RICO ELECTRIC POWER AUTHORITY
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STATEMENT OF NET POSITION (DEFICIT) (IN THOUSANDS)
JUNE 30, 2017

	<u>2017</u>
ASSETS AND DEFERRED OUTFLOWS OF RESOURCES	
Currents assets:	
Cash and cash equivalents	\$ 532,943
Accounts receivable, net	853,909
Fuel inventory	101,634
Materials, supplies and prepayments	<u>112,172</u>
Total current assets	<u>1,600,658</u>
Non-current assets:	
Restricted cash and cash equivalents	53,950
Non-current accounts receivable	10,513
Depreciable capital assets	5,675,112
Land	148,317
Construction in progress	<u>473,553</u>
Total non-current assets	<u>6,361,445</u>
Total assets	<u>7,962,103</u>
Deferred outflows of resources:	
Related to pensions	1,541,743
Related to debt refunding	40,994
Related to derivative instruments	<u>48,132</u>
Total deferred outflows of resources	<u>1,630,869</u>
Total assets and deferred outflows of resources	<u>\$ 9,592,972</u>

Continued

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STATEMENT OF NET POSITION (DEFICIT) (IN THOUSANDS)
JUNE 30, 2017

Continues

	<u>2017</u>
LIABILITIES DEFERRED INFLOWS OF RESOURCES AND NET POSITION	
Currents liabilities:	
Accounts payable and accrued liabilities	\$ 1,085,934
Notes payable	732,743
Customers' deposits	<u>6,902</u>
Total current liabilities	<u>1,825,579</u>
Current liabilities payable from restricted assets:	
Current portion of bonds payable	584,582
Accrued interest	<u>228,265</u>
Total current liabilities payable from restricted assets	<u>812,847</u>
Non-current liabilities:	
Bonds payable	7,771,732
Net pension liability	4,666,535
Customers' deposits	193,374
Claims and judgments	123,409
Other post-employment benefits liability	123,813
Compensated absences	88,232
Fair value of derivative instruments	48,132
Notes payable	<u>20,569</u>
Total non-current liabilities	<u>13,035,796</u>
Total liabilities	<u>15,674,222</u>
Deferred inflows of resources:	
Related to pension	47,343
Related to infeasible right to use agreements	7,535
Related to contributions made by clients for specific projects	<u>4,441</u>
Total deferred inflows of resources	<u>59,319</u>
Net position (deficit):	
Net investment in capital assets	(2,075,907)
Unrestricted	<u>(4,064,662)</u>
Total net position (deficit)	<u>\$ (6,140,569)</u>

The accompanying notes are an integral part of these financial statements.

PUERTO RICO ELECTRIC POWER AUTHORITY
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STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION (DEFICIT)
(IN THOUSANDS)
FOR THE YEAR ENDED JUNE 30, 2017

	<u>2017</u>
Operating revenues, net:	<u>\$ 3,298,223</u>
Operating expenses:	
Operations:	
Fuel	1,217,525
Purchased power	728,872
Depreciation	519,406
Maintenance	355,844
Transmission and distribution	354,563
Administrative and general	322,475
Customer accounting and collection	242,898
Other production	<u>118,570</u>
Total operating expenses	<u>3,860,153</u>
Operating loss	(561,930)
Non-operating revenues and (expenses):	
Customer charges, penalties and other	37,117
Interest expense on bonds	(430,652)
Interest expense on notes payable and other long-term debt	(53,736)
Amortization of debt premium/(discount), issuance costs and refunding loss	<u>1,531</u>
Total non-operating revenues and (expenses), net	<u>(445,740)</u>
Loss before contribution in lieu of taxes and capital contributions	(1,007,670)
Contribution in lieu of taxes	(178,003)
Capital contributions	<u>7,317</u>
Change in net position (deficit)	(1,178,356)
Net position (deficit), at beginning of year (as restated)	<u>(4,962,213)</u>
Net position (deficit), at end of year	<u>\$ (6,140,569)</u>

The accompanying notes are an integral part of these financial statements.

PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF CASH FLOWS (IN THOUSANDS)
FOR THE YEAR ENDED JUNE 30, 2017

	<u>2017</u>
CASH FLOWS FROM OPERATING ACTIVITIES:	
Cash received from customers	\$ 3,405,150
Cash paid to suppliers	(2,340,699)
Cash paid to employees	<u>(470,164)</u>
Net cash flows provided by operating activities	594,287
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:	
Proceeds from notes payable	4,614
Principal paid on notes payable	(2,717)
Interest paid on notes payable	<u>(51,463)</u>
Net cash flows used in noncapital financing activities	(49,566)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES:	
Construction expenditures	(171,646)
Proceeds received from capital contributions	2,211
Proceeds from issuance of bonds, net of discount	23,632
Deferred outflows of resources related to debt refunding	(7,429)
Change in value of derivative	(20,778)
Interest paid on revenue bonds	<u>(218,492)</u>
Net cash flows used in capital and related financing activities	(392,502)
Net increase in cash and cash equivalents	152,219
Cash and cash equivalents, at beginning of year	<u>434,674</u>
Cash and cash equivalents, at end of year	<u>\$ 586,893</u>

Continued

PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
STATEMENT OF CASH FLOWS (IN THOUSANDS)
FOR THE YEAR ENDED JUNE 30, 2017

Continues

	<u>2017</u>
CASH AND CASH EQUIVALENTS:	
Unrestricted	\$ 532,943
Restricted	<u>53,950</u>
	<u>\$ 586,893</u>
RECONCILIATION OF OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
OPERATING LOSS	\$ (561,930)
ADJUSTMENTS TO RECONCILE OPERATING LOSS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:	
Depreciation	519,406
Provision for uncollectible accounts and other	124,892
(Increase) decrease of assets:	
Receivables	(162,516)
Fuel oil	(33,415)
Materials and supplies	(3,914)
Prepayments and other assets	18,905
Deferred outflows related to pensions	(360,052)
Other deferred outflows	30,174
Noncurrent liabilities, excluding revenue bonds and notes payable	(1,307)
Accounts payable and accrued liabilities	(36,188)
Net pension liability	1,062,733
Deferred inflow of resources	(11,341)
Customer's deposits	<u>8,840</u>
Total adjustments	<u>1,156,217</u>
Net cash flows provided by operating activities	<u>\$ 594,287</u>
SUPPLEMENTAL CASH FLOWS INFORMATION:	
Noncash transactions:	
Capital contributions	<u>\$ 5,105</u>
Change in fair value of derivative instruments	<u>\$ 20,778</u>
Changes in deferred loss resulting from debt refunding	<u>\$ (7,430)</u>

The accompanying notes are an integral part of these financial statements.

PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2017

1. REPORTING ENTITY

Puerto Rico Electric Power Authority (the "Authority") is a public corporation and component unit of the Commonwealth of Puerto Rico (the "Commonwealth") created on May 2, 1941, pursuant to Act No. 83, as amended, (the "Act"). The Authority transmits and distributes, substantially, all of the electric power consumed and produces a majority of the electricity generated in Puerto Rico. Also, the Authority operates, pursuant to Acts No. 83 and 84, approved on June 20, 1955, regarding the Puerto Rico Irrigation Service, Costa Sur, and Isabela Irrigation Service, respectively, and the Lajas Valley Public Irrigation Law, Act 65 approved on June 10, 1953, as amended. The Authority has broad powers including, among others, to issue bonds for any of its corporate purposes subject to the limitations set forth in a Trust Agreement dated as of January 1, 1974, as amended (the "1974 Agreement").

On May 27, 2014, the Commonwealth approved Act No. 57, which authorizes the Puerto Rico Energy Bureau (then known as the Puerto Rico Energy Commission) to approve electric rates proposed by the Authority among other matters. On February 16, 2016, the Commonwealth approved Act No. 4, also known as the Puerto Rico Electric Power Authority Revitalization Act, which modifies the regulatory framework to establish electric rates, code of conduct matters and establishes a legal and judiciary framework for the restructuring of the Authority's debt.

As discussed in Notes 3 and 19, on July 2, 2017, the Financial Oversight and Management Board filed a petition under Title III of PROMESA in the United States District Court for the District of Puerto Rico, commencing a Title III case for the Authority. The Authority's petition for relief is still under evaluation by the Court. The accompanying basic financial statements do not include any adjustments that might result from the outcome of the Title III petition.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the most significant accounting policies followed by the Authority in preparing its financial statements:

a. Basis of Accounting

The financial statements are presented as an enterprise fund prepared using the economic resources measurement focus and the accrual basis of accounting, in accordance with the accounting principles generally accepted in the United States of America for governments as prescribed by the Governmental Accounting Standards Board ("GASB"). Accordingly, revenues are recognized when earned and expenses when incurred, regardless of when cash is received or paid. The Authority accounts for its operations and financings in a manner similar to private business enterprises; the intent is that costs of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges.

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b. Blended Component Unit

The financial statements of the Authority include, as a blended component unit, the financial position and operations of PREPA Holdings, LLC ("PREPA Holdings"), a fully owned subsidiary, created as a holding company of PREPA Networks, LLC, InterAmerican Energy Sources, LLC, Consolidated Telecom of Puerto Rico, LLC, and International Network Operations, LLC. These entities are included as part of the reporting entity of PREPA Holdings, LLC. The basis for the blended presentation is that PREPA Holdings, LLC was created by the Authority's Governing Board pursuant to Resolution No. 3661 adopted on October 16, 2009. PREPA Holding, LLC is a single member limited liability company and the Authority is the sole member with shared Management representatives. PREPA Holdings, LLC has nine Managers, two are members of the Governing Board of the Authority, three are the Authority's Executive Director, the Authority's Director of Finance and the Authority's Director of Environmental Planning and Protection.

PREPA Networks, LLC was created on November 12, 2008, as a Delaware limited liability company, for the purpose of marketing the excess communication capacity of the Authority's fiber optic cable system. PREPA Networks, LLC currently offers next generation telecommunications services to carriers, internet service providers, and large commercial enterprises. These services include data transmission via Synchronous Optical Network metro and longhaul Ethernet transport services, wireless last mile, and internet protocol services optimized for voice over internet protocol. PREPA Networks, LLC also offers international fiber optic cable capacity and satellite teleport facilities through submarine fiber optic cable capacity.

InterAmerican Energy Sources, LLC was created on May 25, 2007, as a Delaware limited liability company, for the purpose of investing, developing, financing, constructing and operating renewable energy projects and other infrastructure related to the optimization of the Authority's electric infrastructure. InterAmerican Energy Sources, LLC is currently not operating.

Consolidated Telecom of Puerto Rico, LLC, ("CTPR") was created on October 27, 2009, as a Delaware limited liability company, for the purpose of developing, financing, constructing and operating a telecommunications business within or outside of the Commonwealth, directly or indirectly, in relation to the operations of the Authority.

On May 2, 2017, CTPR acquired the 100% membership interest of On Net Puerto Rico, LLC ("On Net"), a Puerto Rico limited liability company. In exchange for the 100% of the membership interest of On Net, CTPR contributed with the following assets:

- CTPR's right, titles, relationship and interest in the contracts executed by CTPR with end-customers for the provision of telecommunications service and others;

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- Accounts receivable of those agreed end-customers; and
- All of CTPR's rights, titles and interest in CTPR's trademarks with the doing business as On Net Fiber Powered Networks.

These assets were valued at \$1.3 million, at the date of the membership acquisition of On Net. Effective June 30, 2017, CTPR sold its 100% of its issued and outstanding membership interest in On Net. As of fiscal year ended June 30, 2017, On Net is not currently operating.

CTPR continued its operations until June 30, 2018. Effective July 1, 2018, its operations were transferred to PREPA Net. CTPR will remain in existence as an inactive company.

International Network Operations, LLC was created on June 15, 2017, as a Delaware limited liability company, for the purpose of investing, developing, financing, construction and operating a new generation fiber optic business and other telecommunications technologies, which includes international services directly or indirectly relating to the infrastructure of the Authority. International Network Operations, LLC is currently not operating.

Condensed financial information for PREPA Holdings, LLC as of June 30, 2017 is as follows:

	<u>2017</u> <i>(In thousands)</i>
Statement of net position:	
Total Assets:	
Current assets	\$ 7,533
Non-current assets	7,189
Capital assets, net of depreciation	<u>53,872</u>
Total assets	<u>\$ 68,594</u>
Liabilities:	
Current liabilities	\$ 3,878
Non-current liabilities	<u>30,441</u>
Total liabilities	<u>34,319</u>
Deferred inflows of resources	<u>7,535</u>
Net investment in capital assets	38,579
Unrestricted (deficit)	<u>(11,839)</u>
Net position	<u>\$ 26,740</u>

Continued

PUERTO RICO ELECTRIC POWER AUTHORITY
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NOTES TO THE FINANCIAL STATEMENTS
FOR THE YEAR ENDED JUNE 30, 2017

Continues

	<u>2017</u> <i>(In thousands)</i>
Statement of revenues, expenses and changes in net position:	
Operating revenues	\$ 15,163
Operating expenses	(12,929)
Operating income	<u>2,234</u>
Non-operating revenues	<u>681</u>
Change in net assets	2,915
Net position, beginning balance	<u>23,825</u>
Net position, ending balance	<u>\$ 26,740</u>
Statement of cash flows:	
Net cash provided by operating activities	\$ 5,930
Net cash used in financing activities	(872)
Net cash used in capital and related financing activities	(5,273)
Net cash provided from investing activities	<u>541</u>
Net increase in cash	326
Cash, at beginning of year	<u>3,415</u>
Cash, at end of year	<u>\$ 3,741</u>

Questions or requests related to the financial information of PREPA Holdings, LLC should be addressed to PREPA Holdings, LLC, Condominium Aquablue at the Golden Mile, Commercial Building Fourth Floor, 48 Muñoz Rivera Avenue, San Juan, Puerto Rico, 00918.

c. Cash and Cash Equivalents

The Authority considers all highly liquid investments with original maturity of three months or less to be cash equivalents.

d. Accounts Receivable

Accounts receivable are stated net of estimated allowances for uncollectible accounts, which are determined, based on subsequent collections and current economic conditions, among other factors. The Authority establishes a general or specific allowance for each group of customers (i.e., residential, commercial, industrial, and governmental). The Authority has significant amounts receivable from the Commonwealth, its components units and municipalities. There is uncertainty regarding to the collection of such receivables due to the financial challenges these entities are facing. The Authority has considered this in its estimate of the specific governmental allowance for uncollectible accounts. Because of uncertainties inherent in the estimation process, management's estimate of credit losses inherent in the existing accounts receivable and related allowance may change in the future.

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e. Fuel Inventory

Fuel inventory represents the value of low sulfur and other liquid fuel that the Authority had on hand at year-end in order to meet the demand requirements of their generating stations. Fuel inventory is valued using the weighted average cost method. At the time of consumption, an expense is recorded at the weighted average cost.

f. Materials and Supplies Inventory

The materials and supplies inventory support the operations and maintenance of the transmission and distributions system. The inventory is accounted for on an average cost basis of accounting. As of the fiscal year ended June 30, 2017, the Authority has recognized \$46 million in allowance for obsolescence.

g. Restricted Cash and Cash Equivalents

Restricted cash and cash equivalents are amounts set aside for construction, debt service payments or other specific purposes which are limited for these purposes by the applicable agreements.

When both restricted and unrestricted resources are available for a specific use, it is the Authority's policy to use restricted resources first, then unrestricted resources as they are needed.

h. Capital Assets

Utility plant is carried at cost, which includes labor, materials, overhead, and an allowance for the cost of funds used during construction ("AFUDC"). AFUDC represents the cost of borrowed funds used to finance construction work in progress. AFUDC is capitalized as an additional cost of property and as a decrease of interest expense. Capitalized interest expense is reduced by investment earnings from related investments acquired with proceeds of tax-exempt borrowings. During the year ended June 30, 2017, the Authority early adopted the provisions of GASB Statement 89, *"Accounting for Interest Cost Incurred before the End of a Construction Period"*. As a result of this adoption, the Authority ceased the capitalization of interest cost incurred during the construction period of its infrastructure.

Capital expenditures of \$1,200 or more are capitalized at cost at the date of acquisition. Maintenance, repairs, and the cost of renewals of minor items of property units are charged to operating expenses. The cost of retired property, together with removal cost less salvage, is charged to accumulated depreciation with no gain or loss recognized.

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Capital assets donated by third parties are recorded at acquisition value at the time of donation. Capital contributions consist principally of infrastructure assets that are constructed by private entities, for residential, commercial or industrial projects, that are transferred upon completion of the projects, for the Authority to connect the facilities to the electric grid. Capital assets donated by related parties (i.e. the Commonwealth or other component units of the Commonwealth) are recorded at the carrying value existing at the transferor's records. For the fiscal year ended June 30, 2017, the Authority received 5.1 million in capital assets which were recognized as capital contribution.

Impairment of Capital Assets

The Authority evaluates significant events or changes in circumstances that may affect its capital assets to determine whether impairment of a capital asset occurred. Such events may include evidence of physical damage, enactment or approval of laws or regulations or other changes in environmental factors, technological changes or evidence of obsolescence, changes in the manner or duration of use of a capital asset, and construction stoppage among others, that results in the significant and unexpected decline of the asset's service utility or capacity. Impaired capital assets that the Authority will continue to use are estimated using methods that best reflect the diminished utility of the capital asset. Impaired capital assets that the Authority will no longer use, are reported at the lower of carrying value or fair value, less cost of disposition. For the year ended June 30, 2017, the Authority recognized an impairment loss of \$2.3 million for its capital assets, as a result of obsolescence of two electric generation turbines.

i. Depreciation and Amortization

The Authority uses the composite depreciation method. Depreciation expense for plant in service results from the application of rates determined by age life studies of assets in service. The rates are applied to groups of depreciable properties. Effective July 1, 2016, the Authority revised its depreciation rates to reflect the adjusted remaining net book value and useful lives of the plant assets resulting in an average composite depreciation rate of approximately 4.57% for June 30, 2017. The annual composite rate of depreciation determined by the Authority for the year ended June 30, 2016, was approximately 4.71%.

Separately, capital lease assets and leasehold improvements are being amortized over the lesser of the life of the assets or the term of the lease, using the straight-line method. Property and equipment, other than those included in composite calculation, are being depreciated over its estimated useful life using the straight-line method.

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The following are the estimated useful lives by category as determined by the depreciation study:

Category	Useful Life (in years)
Transmission	35 to 65
Buildings and building improvements	32 to 50
Distribution	20 to 45
Production	20 to 70
General and administrative	15 to 30
Irrigation systems	14 to 100
Fiber network	5 to 23
Vehicles	5 to 20
Equipment	5 to 15

j. Deferred Outflows/Inflows of Resources

Deferred outflows of resources represent a consumption of net position that applies to a future period and so will not be recognized as an outflow of resources (expense) until then. The Authority has the following deferred outflows of resources:

- Difference between expected and actual experience, changes in assumptions and employer's contribution to the pension plan subsequent to the measurement date of the net pension liability.
- Unamortized deferred loss from debt refunding.
- Accumulated decrease in the fair value of derivatives instruments.

The employer contributions to the pension plan subsequent to the measurement date of the net pension liability are deferred and reduced in future periods from the net pension liability.

A loss on a bond refunding results from the difference in the carrying value of refunded debt and its reacquisition price. This amount is deferred and amortized as a component of interest expense over the shorter of the life of the refunded or refunding debt.

With respect to derivatives instruments, the accumulated losses on their fair values are also deferred and amortized as the underlying hedged instrument (in this case, debt) is being repaid or refunded and/or as the hedging derivative is terminated.

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The Authority's has the following deferred inflows of resources:

- Deferred gain on pension valuation.
- Cash contributions from clients for specific construction projects.
- Cash received by PREPA Networks, LLC for the Indefeasible Right of Use ("IRU"), related to fiber optic communication network controlled by PREPA Networks, LLC not yet provided.

k. Debt Issuance Premiums and Discounts

Debt issuance costs are recorded as expenses when they are incurred. Premium and discounts in the issuance of bonds are deferred and amortized using the straight-line method, which approximates the interest method, over the term of the related bonds.

Bonds payable are reported net of applicable bond premium or discount.

l. Pensions

Eligible employees of the Authority are members of the Employees' Retirement System of the Puerto Rico Electric Power Authority, a single-employer defined benefits pension plan (the "Plan"). Contributions by the Authority and members are based on rates established by the System's Board of Trustees, based on the recommendations of the System's actuaries.

The Authority recognizes a net pension liability, which represents the excess of the total pension liability over the fiduciary net position of the pension plan, as reflected in the financial statements of the Plan. The net pension liability is measured as of the Authority prior fiscal year-end. Changes in the net pension liability are recorded in the period incurred, as pension expense or as deferred inflows of resources or deferred outflows of resources, depending on the nature of the change. The changes in net pension liability that are recorded as deferred inflows of resources or deferred outflows of resources (that arise from changes in actuarial assumptions or other inputs and differences between expected or actual experience) are amortized over the weighted average remaining service life of all participants in the respective pension plan and are recorded as a component of pension expense beginning with the period in which they are incurred. Projected earnings on pension investments are recognized as a component of pension expense. Differences between projected and actual investment earnings are reported as deferred inflows of resources or deferred outflows of resources and amortized as a component of pension expense on a closed basis over a five-year period beginning with the period in which the difference occurred. Each subsequent year will incorporate an additional closed basis five-year period of recognition. Contributions made after the measurement date are recorded as deferred outflows.

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For purposes of measuring the net pension liability and deferred outflows/inflows or resources relating to pensions, and pension expense, information about the fiduciary net position of the Plan and additions to/deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported by the Plan. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefits terms. Investments are reported at fair value. Refer to Note 13 for information of where to find the complete Plan's financial statement.

m. Customer Deposits

The Authority requires deposits from its customers before an electric service connection is activated. Deposits are recorded as a liability in the Statement of Net Position, until termination of service. At the moment of termination or cancellation of the electric service, the deposit is applied to the account outstanding balance. Any excess between outstanding balance and deposit is refunded to the customer. As of June 30, 2017, the customer deposit account balance was approximately \$200 million.

n. Compensated Absences

Employees earn annual vacation leave at the rate of 15 days per year up to a maximum permissible accumulation of 60 days for union employees and management personnel.

Employees accumulate sick leave at the rate of 18 days per year up to a maximum permissible accumulation of 90 days. Unused sick leave is not payable.

The Authority records as a liability and as an expense the vested accumulated vacation and sick leave as benefits accrue to employees. The cost of vacation and sick leave expected to be paid in the next twelve months is classified as current, included as a portion of accounts payable and accrued liabilities (Note 9), while amounts expected to be paid after twelve months are classified as noncurrent liabilities.

o. Revenue Recognition, Fuel Costs and Purchased Power

Clients are billed monthly. Revenues are recorded based on services rendered during each accounting period, including an estimate for unbilled services, net of discounts and allowances. Revenues include amounts resulting from a fuel and purchased power cost recovery clause ("Fuel Adjustment Clause"), which is designed to permit full recovery through customer billings of fuel costs and purchased power. Fuel costs and purchased power are reflected in operating expenses as the fuel and purchased power are consumed.

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p. Non-operating revenues

Non-operating revenues are generated by activities outside of the operating activities of the Authority. For the fiscal year ended June 30, 2017, the Authority had the following non-operating revenue activities:

- Charges to customers related to administrative fines or penalties for irregularities in electric energy consumption, late payment penalties, service charges and interest charges from payment arrangements with customers.
- Revenue from the rental of electric pole spaces to private clients from the communication industry.
- Monthly interest income from cash held in bank accounts and certificates of deposit.

q. Contributions in Lieu of Taxes

The contribution in lieu of taxes ("CILT") is an amount that represents the electric power service provided by the Authority to the Municipalities of Puerto Rico, in exchange of complete exemption from municipal taxes pursuant to the provisions of section 22 of Act 83, approved May 2, 1941, as amended.

r. Risk Management

The Authority purchases commercial insurance covering casualty, theft, tort claims, natural disaster and other claims covering all risk property (excluding transmission and distribution lines), boiler and machinery, boiler, machinery and public liability. In the last three fiscal years, insurance settlements have not exceeded the coverage amounts. The Authority has no general property insurance for its transmission and distribution lines, and is self-insured.

s. Estimates

The preparation of the basic financial statements in conformity with accounting principles generally accepted ("GAAP") in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the basic financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

t. Interest-Rate Swap Agreements

The interest-rate swaps are used to take advantage of favorable market interest rates and to limit interest rate risk associated with variable rate debt exposure.

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Under the interest-rate swap programs, the Authority pays fixed and variable rates of interest based on various indexes for the term of the variable interest rate Power Revenue Bonds and receives a variable rate of interest, which is also based on various indexes. These indexes are affected by changes in the market. The net amount received or paid under the swap agreements is recorded as an adjustment to interest expense. The interest rate swaps are reported at fair value in the statement of net position (deficit). The changes in fair value for effective hedges are recorded as deferred inflows of outflows of resources in the statement of net position. The changes in fair value for ineffective hedges are reported in investment income.

u. Claims and Judgments

The estimated amount of the liability for claims and judgments is based on the Authority's evaluation of the probability of an unfavorable outcome in the litigation of such claims and judgments. The Authority consults with legal counsel upon determining whether an unfavorable outcome is expected. Because of uncertainties inherent in the estimation process, management's estimate of the liability for claims and judgments may change in the future. However, most legal claims are currently on stay ordered by the Federal Bankruptcy Court. See Note 19 for additional information regarding Title III PROMESA filing.

v. Fair Value Measurements

GASB Statement No. 72, Fair Value Measurement and Application, establishes general principles for measuring fair value and standards of accounting and financial reporting for assets and liabilities measured at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is a market-based measurement, not an entity-specific measurement. For some assets and liabilities, observable market transactions or market information might be available; for others, it might not be available.

The fair value hierarchy categorizes the inputs to valuation techniques used to measure fair value into three levels as described below:

Level 1 - measurements that use quoted prices (unadjusted) for identical assets or liabilities in active markets that the Authority has the ability to access at the measurement date.

Level 2 - measurements other than quoted prices included within Level 1 that are observable for an asset or liability, either directly or indirectly.

Level 3 - measurements that use unobservable inputs for an asset or liability. In some valuations, the inputs used may fall into different levels of hierarchy. In these cases, the financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

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See Note 12 for further discussion of the Authority's fair value of its interest swap agreements.

Donated capital assets are recorded at acquisition value at time of donation.

3. FINANCIAL CONDITION AND LIQUIDITY

The Authority defaulted on various debt obligations that were due on July 1, 2017, and does not currently have sufficient funds available to fully repay its various obligations as they come due.

The Commonwealth and its components units are also experiencing financial difficulties and have been unable to pay amounts due to the Authority. The Authority has accounts receivable of approximately \$231 million from the Commonwealth and its component units and there is substantial doubt that the Authority will be able to collect the full amount of these receivables. As a result, for the year ended June 30, 2017, the Authority has recorded an additional allowance for uncollectible accounts amounting to \$138 million for uncollectability based on subsequent collections.

During the year ended June 30, 2017, the Authority did not make the required deposits into the Sinking Fund, payments to current fuel lines of credit, notes payable, and the complete portion of the required employer contribution to the Puerto Rico Electric Power Authority Employee Retirement System, due to liquidity constraints.

As of June 30, 2017, the Authority has an accumulated deficit of approximately \$6.1 billion. The Authority faces a number of business challenges that have been exacerbated by the Commonwealth's economic situation, the volatility in oil prices, and that the Authority has not increased its customers' rates to levels sufficient to offset the effects of its rising costs. Its principal challenges, some of which are interrelated, are: (i) addressing the decline in electric energy demand; (ii) addressing the volatility of oil costs; (iii) addressing high customer electric power rates; (iv) reducing government accounts receivables; and (v) improving its liquidity.

As discussed in Note 19, on July 2, 2017, the Financial Oversight and Management Board filed a petition under Title III of PROMESA in the United States District Court for the District of Puerto Rico, commencing a Title III case for the Authority. The Authority's petition for relief is still currently under evaluation. The accompanying basic financial statements do not include any adjustments that might result from the outcome of the Title III petition.

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4. PRIOR PERIOD ADJUSTMENTS

During the year ended June 30, 2017, the Authority identified the following misstatements related to prior year financial statements, which resulted in restatements of the beginning net position of the Authority's financial statements. The impact of these adjustments to net position (deficit) were as follows (in thousands):

	Allowance for Uncollectible Accounts	Capital Assets	Legal Claims and Judgments Reserve	Net Position (Deficit)
As previously reported	\$ (169,738)	\$ 6,702,210	\$ (44,065)	\$ (4,838,066)
Correction of capital assets accounts	-	(96,139)	-	(96,139)
Correction of accumulated depreciation	-	36,347	-	36,347
Correction of allowance for uncollectible accounts	12,994	-	-	12,994
Correction of claims and judgments	-	-	(77,349)	(77,349)
Beginning balances, as restated	<u>\$ (156,744)</u>	<u>\$ 6,642,418</u>	<u>\$ (121,414)</u>	<u>\$ (4,962,213)</u>

Correction of errors:

A. Allowance for Uncollectible Accounts

A number of misstatements in the determination of the allowance for uncollectible accounts from prior years were found in the beginning balance. The effect of this correction represents a decrease of \$12.9 million in the prior year net deficit.

B. Capital Assets

A number of misstatements were found in beginning balances of capital assets, that occurred during prior years, which consisted of the following:

- Duplicated fixed assets within the subsidiary ledger, causing an overstated balance in capital assets of \$79.1 million.
- Unfeasible projects that were considered aged and subject to write-off, causing an overstated balance in capital assets of \$17 million.
- Accumulated depreciation amounts for projects that had been previously retired, causing an overstatement balance of \$36.3 million.

The net effect of these corrections represents an increase of \$59.8 million in prior year net deficit.

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C. Claims and judgments

The beginning balances of the legal claims and judgment reserve was corrected to include labor related claims from prior years that were omitted. The effect of this correction is an increase of \$77.7 million in net deficit.

5. CASH AND CASH EQUIVALENTS

At June 30, 2017, the carrying amount and bank balance of cash deposits held by the Authority in commercial banks and restricted cash deposits held by the Trustee under the 1974 Agreement is as follows (in thousands):

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Unrestricted	\$ 532,943	\$ 527,735
Restricted - Held by Trustee	<u>53,950</u>	<u>55,345</u>
Total	<u>\$ 586,893</u>	<u>\$ 583,080</u>

Custodial Credit Risk - Deposits in Commercial Banks

Custodial credit risk is the risk that in the event of a bank failure, the bank's deposits may not be returned. The Commonwealth requires that public funds deposited in commercial banks in Puerto Rico must be fully collateralized. The Authority's policy is to deposit funds with institutions that provides insurance or securities as collateral. Such collateral is held by the Department of the Treasury of the Commonwealth.

All moneys deposited with the Trustee or any other depository under and as defined in the 1974 Agreement in excess of the amount guaranteed by the Federal Deposit Insurance Corporation or other federal agency are continuously secured with a bank or trust company approved by the Authority and by the Trustee as custodian, or, if then permitted by law, by setting aside under control of the trust department of the bank holding such deposit, as collateral security, Government Obligations (as defined in the 1974 Agreement) or other marketable securities.

Closure of the Government Development Bank for Puerto Rico ("GDB")

During the year ended June 30, 2015, the Authority recognized a custodial credit risk loss of \$144.7 million for the deposits at the GDB that were deemed to be unrecoverable as a result of GDB's financial distress, which eventually resulted in its closure. However, as discussed on Note 19, on February 12, 2019, as a result of the GDB Restructuring Committee Settlement Stipulation, the Authority has recovered approximately \$15.3 million as a partial payment of the claims. However, because of uncertainties as of the date of the financial statements, the Authority will consider recognition of recovered amount, if any, when the complete settlement is received.

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6. ACCOUNTS RECEIVABLE

Accounts receivable consist of (in thousands):

Current:

Electric and related services:	
Commonwealth agencies and component units	\$ 90,685
Municipalities	382,081
Residential, industrial and commercial	874,691
Unbilled services	166,273
Fiber optic and others	2,783
	<u>1,516,513</u>
Allowance for uncollectible accounts	<u>(677,754)</u>
Total	838,759
Receivable from insurance companies and other	14,997
Accrued interest on investments	153
	<u>153</u>
Total current accounts receivable	<u>\$ 853,909</u>

Noncurrent:

Electric and related services:	
Governmental agencies and municipalities, net of allowance for uncollectible accounts of \$130.6 million	\$ 3,325
Receivable related to indefeasible right of use agreements from the Puerto Rico Aqueduct and Sewer Authority	<u>6,428</u>
Total non-current receivable related to government	9,753
Other non-current receivable not related to government	<u>760</u>
Total non-current accounts receivable	<u>\$ 10,513</u>

Governmental accounts receivable related to Commonwealth agencies, other component units of the Commonwealth and municipalities consist of (in thousands):

	Commonwealth Agencies	Commonwealth Component Units	Municipalities	Total
Current:				
Accounts receivable	\$ 14,577	\$ 76,108	\$ 939	\$ 91,624
Receivables subject to CILT	-	-	381,142	381,142
Allowance for uncollectible accounts	-	-	-	-
Total current governmental accounts receivable	<u>\$ 14,577</u>	<u>\$ 76,108</u>	<u>\$ 382,081</u>	<u>\$ 472,766</u>
Noncurrent:				
Account receivable	\$ 2,037	\$ 122,748	\$ 15,533	\$ 140,318
Allowance for uncollectible accounts	<u>(2,037)</u>	<u>(112,995)</u>	<u>(15,533)</u>	<u>(130,565)</u>
Total non-current governmental accounts receivable	<u>\$ -</u>	<u>\$ 9,753</u>	<u>\$ -</u>	<u>\$ 9,753</u>

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As of June 30, 2017, receivables from the municipalities subject to CILT amounted to approximately \$381.1 million which the Authority has the right to offset with contribution in lieu of taxes payable to such municipalities.

The portion of accounts receivable and other governmental receivables not expected to be collected during the next fiscal year are reflected as other noncurrent receivable.

The Authority has recorded an allowance for uncollectible accounts estimated at \$138 million for the year ended June 30, 2017, in consideration of the financial difficulties being experienced by the Commonwealth, its component units and municipalities.

7. RESTRICTED ASSETS

At June 30, 2017, the Authority had the following restricted assets (in thousands):

	<u>Cash and Cash Equivalents</u>
Construction Fund	\$ 23,866
Reserve Maintenance Fund	16,150
Reserve Account in the Sinking Fund	8,805
PREPA Client Fund	3,195
Other Restricted Funds	<u>1,934</u>
Total	<u>\$ 53,950</u>

- Construction Fund - The proceeds of any Power Revenue Bonds issued for the purpose of paying the cost of acquiring or constructing improvements, together with the money received from any other source for such purpose, except proceeds which are (i) applied to the repayment of advances, (ii) deposited in the 1974 Reserve Account, (iii) deposited in the Bond Service Account as capitalized interest or (iv) used for the payment of financing expenses, shall be deposited in the 1974 Construction Fund and held by the Authority in trust. During fiscal year 2017, the Authority deposited \$4.6 million into the 1974 Construction Fund.
- Reserve Maintenance Fund - Fund to pay the cost of unusual or extraordinary maintenance or repairs, not recurring, and renewals and replacements, including major items of equipment. The Reserve Maintenance Fund also serves as an additional reserve for the payment of principal and interest on the Power Revenue Bonds and meeting the amortization requirements to the extent that moneys in the 1974 Sinking Fund, including money in the 1974 Reserve Account, are insufficient for such purpose. The Authority did not make any deposits into the 1974 Reserve Maintenance Fund during fiscal year ended June 30, 2017.

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- Reserve Account in the Sinking Fund - Current year requirements for principal and interest on Power Revenue Bonds. The Authority did not make required deposits into 1974 Sinking Fund Principal and Interest during current fiscal year.
- PREPA Client Fund - Funds received from PREPA Holdings to help stabilize the price of electric power provided to the Authority's clients.
- Other Restricted Funds - Funds deposited under the Land Acquisition Project, a consent decree between the Authority and the U.S. Department of Justice, dated March 19, 1999, where the Authority agreed to deposit \$3.4 million into an interest bearing escrow account to implement an environmental restoration and protection project. The primary purpose of the project is the acquisition and preservation of land in or adjacent to the Cucharillas marsh in Cataño.

8. CAPITAL ASSETS

The Authority had the following activities in capital assets (in thousands):

	Balance June 30, 2016 (as restated)	Additions	Retirements and Disposals	Transfers and adjustments	Balance June 30, 2017
Non-depreciable utility plant:					
Land and land improvements	\$ 146,475	\$ 90	\$ -	\$ 1,752	\$ 148,317
Construction work in process	482,134	169,032	-	(177,613)	473,553
Total non-depreciable utility plant	628,609	169,122	-	(175,861)	621,870
Depreciable utility plant:					
Production	4,648,572	-	-	37,383	4,685,955
Distribution	4,335,156	-	(1,178)	75,895	4,409,873
Transmission	2,373,275	-	(849)	13,986	2,386,412
General and administrative	1,422,253	-	-	21,342	1,443,595
Fiber network	69,230	2,570	-	-	71,800
Irrigation systems	33,874	-	-	-	33,874
Total depreciable utility plant	12,882,360	2,570	(2,027)	148,606	13,031,509
Accumulated depreciation:					
Production	(2,574,435)	(171,961)	-	25,965	(2,720,431)
Distribution	(2,499,927)	(216,545)	1,178	1,695	(2,713,599)
Transmission	(973,878)	(64,160)	849	820	(1,036,369)
General and administrative	(776,801)	(63,287)	-	1,053	(839,035)
Irrigation systems	(21,857)	(476)	-	-	(22,333)
Fiber network	(21,653)	(2,977)	-	-	(24,630)
Total accumulated depreciation	(6,868,551)	(519,406)	2,027	29,533	(7,356,397)
Total capital assets	\$ 6,642,418	\$ (347,714)	\$ -	\$ 2,278	\$ 6,296,982

Construction work in progress at June 30, 2017, consists principally of expansions and upgrades to the electric generation, distribution and transmission systems.

Depreciation and amortization expense during fiscal year ended 2017 was approximately \$519 million.

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At June 30, 2017, the Authority recorded an impairment loss of approximately \$2.3 million from two electric generation turbines, based on obsolescence and the fact that these facilities are not expected to be used in the future, because they are not worthy to be repaired. The impairment loss was recorded in operating expenses, as other production, in the statement of revenues, expenses and changes in net position (deficit).

9. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities at June 30, 2017 were as follows (in thousands):

Accounts payable, accrued expenses, and withholdings	\$	520,662
Contribution in lieu of taxes		381,142
Accrued pension plan contribution and withholding from employees		123,792
Compensated absences, excluding long term portion		55,367
Accrued compensation		<u>4,971</u>
Total		<u>1,085,934</u>

10. LONG-TERM LIABILITIES

Long-term debt activity for the year ended June 30, 2017, was as follows (in thousands):

	Balance at June 30, 2016 <i>(as restated)</i>	Issuance/ Accretions	Payments/ Amortization	Balance at June 30, 2017	Due within one year
Notes payable	\$ 751,415	\$ 4,614	\$ (2,717)	\$ 753,312	\$ 732,743
Bonds payable	8,366,753	-	(10,439)	8,356,314	584,582
Compensated absences	166,925	48,974	(72,301)	143,598	55,367
Claims and judgments	<u>121,415</u>	<u>3,870</u>	<u>(1,876)</u>	<u>123,409</u>	<u>11</u>
Total long-term liabilities	<u>\$ 9,406,508</u>	<u>\$ 57,458</u>	<u>\$ (87,333)</u>	<u>\$ 9,376,633</u>	<u>\$ 1,372,703</u>

Due to the Authority's Title III filing, amounts due within one year will not be paid. See Notes 18 and 19.

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11. NOTES PAYABLE

The following is a summary of notes payable as of June 30, 2017 (in thousands):

	<u>Maturity Date</u>	<u>Effective Interest Rate</u>	<u>Current Liabilities</u>	<u>Long-Term Debt</u>	<u>Total</u>
Notes payable, unrestricted:					
Revolving line of credit of \$150 million to finance working capital	January 2015	7.25 % (V)	\$ 146,042	\$ -	\$ 146,042
Revolving line of credit of \$550 million to finance working capital	August 2014	7.25 % (V)	549,950	-	549,950
Line of credit of \$25 million with GDB to finance improvements to Isabela Irrigation System	June 2018	7.00 % (F)	713	-	713
Revolving line of credit of \$27 million to finance improvements in Aguirre	September 2033	2.00 % (F)	-	5,750	5,750
Revolving line of credit with GDB of \$150 million to fund swap's collateral posting	December 2014	6.00 % (V)	35,133	-	35,133
Note Payable of \$10 million (PREPA Holdings) for the purchase of ULTRACOM	February 2023	4.00 % (V)	245	-	245
Note Payable of \$16 million (PREPA Holdings) to finance the general working capital and capital expenditures	January 2023	5.00 % (V)	660	14,819	15,479
Total notes payable			<u>\$ 732,743</u>	<u>\$ 20,569</u>	<u>\$ 753,312</u>

(V) - variable interest rate

(F) - fixed interest rate

The schedule of maturities of notes payable with interest thereon as of June 30, 2017, is as follows (in thousands):

<u>Fiscal Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 732,743	\$ 885	\$ 733,628
2019	660	851	1,511
2020	660	819	1,396
2021	660	784	1,444
2022	660	751	1,411
2023-2027	12,179	881	13,060
2028-2032	-	575	575
2033-2034	5,750	230	5,980
Total notes payable	753,312	5,776	759,088
Less interest	-	(5,776)	(5,776)
Less current portion of notes payable	(732,743)	-	(732,743)
Notes payable, long-term	<u>\$ 20,569</u>	<u>\$ -</u>	<u>\$ 20,569</u>

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The above schedule has been presented in accordance with original terms of the notes payable and do not reflect the effects, if any, that may result from the Title III proceedings. The notes payable are subject to adjustment. Accordingly, the effects of the Title III proceedings may affect the carrying amounts, interest rates and the repayment terms. See Notes 3, 18 and 19 for additional information.

In March 2017, the Authority received approximately \$4.6 million from the revolving line of credit of \$27 million to finance improvements to the Aguirre Power Complex Water Supply and Waste Water Treatment Plan Improvement Revolving Loan, with maturity date in September 2033 and an effective interest of 2%.

On February 28, 2008, PREPA Net entered into a note payable agreement with a commercial bank of approximately \$10.1 million. The note payable bears interest at U.S. prime rate plus .50% (4.75% as of June 30, 2017) and with maturity date in February 2023. Outstanding balance as of June 30, 2017 is \$245 thousand. PREPA Net paid off the outstanding balance in November 2017.

12. BONDS PAYABLE

At June 30, 2017, bonds payable debt consisted of (in thousands):

Bond Issues	Date of Issue	Effective Interest Rate		Fiscal Year of Last Scheduled Maturity	Principal Outstanding
Issue of 2002, Series JJ	January 3, 2002	5.4 %	(F)	2018	\$ 42,315
Issue of 2002, Series LL	July 2, 2002	5.5 %	(F)	2019	77,905
Issue of 2002, Series MM	October 3, 2002	5.0 %	(F)	2023	56,200
Issue of 2003, Series NN	August 19, 2003	5.2 %	(F)	2033	171,525
Issue of 2004, Series PP	August 26, 2004	5.0 %	(F)	2025	84,765
Issue of 2005, Series QQ	April 4, 2005	5.5 %	(F)	2018	35,340
Issue of 2005, Series RR	April 4, 2005	5.0 %	(F)	2028	236,265
Issue of 2005, Series SS	April 4, 2005	5.0 %	(F)	2030	332,205
Issue of 2007, Series TT	May 3, 2007	5.0 %	(F)	2037	643,530
Issue of 2007, Series UU	May 3, 2007	4.0 %	(V)	2031	745,070
Issue of 2007, Series VV	May 3, 2007	5.3 %	(F)	2035	557,410
Issue of 2008, Series WW	June 26, 2008	5.4 %	(F)	2038	610,140
Issue of 2010, Series XX	April 7, 2010	5.3 %	(F)	2040	822,210
Issue of 2010, Series YY	April 29, 2010	6.1 %	(F)	2040	320,175
Issue of 2010, Series ZZ	May 5, 2010	5.1 %	(F)	2028	514,900
Issue of 2010, Series AAA	May 5, 2010	5.3 %	(F)	2031	363,075
Issue of 2010, Series BBB	May 26, 2010	5.4 %	(F)	2028	76,800
Issue of 2010, Series CCC	May 26, 2010	5.1 %	(F)	2028	316,920
Issue of 2010, Series DDD	October 14, 2010	4.5 %	(F)	2024	218,225
Issue of 2010, Series EEE	December 29, 2010	6.1 %	(F)	2040	355,730
Issue of 2012, Series A	May 1, 2012	5.0 %	(F)	2042	630,110
Issue of 2013, Series A	August 21, 2013	6.9 %	(F)	2043	673,145
Issue of 2016, Series A	May 19, 2016	10.0 %	(F)	2019	55,640
Issue of 2016, Series B	June 22, 2016	10.0 %	(F)	2019	55,211
Issue of 2016, Series C	June 30, 2016	5.4 %	(F)	2019	104,600
Issue of 2016, Series D	June 30, 2016	7.5 %	(F)	2020	64,375
Issue of 2016, Series E	June 30, 2016	10.0 %	(F)	2022	94,828
Total principal amount face value					8,258,614
Unamortized premiums and discounts					97,700
Power revenue bonds, net					8,356,314
Amount due within one year					(584,582)
Long-term portion of bonds payable					\$ 7,771,732

(V) - variable interest rate

(F) - fixed interest rate

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The schedule maturities of bonds payable with interest thereon as of June 30, 2017, is as follows (in thousands):

<u>Fiscal Year Ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 581,900	\$ 417,839	\$ 999,739
2019	373,205	402,002	775,207
2020	349,251	376,664	725,915
2021	360,066	358,029	718,095
2022	327,282	337,647	664,929
2023-2027	1,759,795	1,444,745	3,204,540
2028-2032	1,686,700	1,008,095	2,694,795
2033-2037	1,367,020	597,097	1,964,117
2038-2042	1,322,750	233,647	1,556,397
2043	130,645	9,145	139,790
Total	8,258,614	5,184,910	13,443,524
Plus or Less:			
Unamortized discount and premium	97,700	-	97,700
Interest	-	(5,184,910)	(5,184,910)
Total bonds payable	8,356,314	-	8,356,314
Total current portion of bonds payable	(584,582)	-	(584,582)
Bonds payable, excluding current portion	\$ 7,771,732	\$ -	\$ 7,771,732

The above schedule has been presented in accordance with original terms of the bonds payable and do not reflect the effects, if any, that may result from the Title III proceedings. The bonds payable are subject to adjustment. Accordingly, the effects of the Title III proceedings may affect the carrying amounts, interest rates and the repayment terms. See Notes 3, 18 and 19 for additional information.

Power Revenue Bonds Payable

The Authority has issued Power Revenue Bonds to finance the cost of improvements and enhancements of its capital assets. The Authority covenants to fix, charge, and collect rates so that revenues will be sufficient to pay current expenses and to provide the greater of (i) the required deposits or transfers to the Sinking Fund, the 1974 Self-Insurance Fund and the Reserve Maintenance Fund or (ii) 120% of the aggregate principal and interest requirements for the next fiscal year on account of all outstanding Power Revenue Bonds. Gross revenues, exclusive of income on certain investments, less current expenses as defined, shall be pledged to repay Power Revenue Bonds principal and interest. However, during the fiscal year ended June 30, 2017, the Authority did not make the required deposits into the Sinking Fund.

As disclosed in Notes 3, 18 and 19, on July 2, 2017, the Financial Oversight and Management Board filed a petition seeking protection for the Authority under Title III of PROMESA in the United States District Court for the District of Puerto Rico, commencing a Title III case for the Authority. Title III of PROMESA establishes an in-court process for restructuring the debts of Puerto Rico and other United States territories that is modeled after the process under Chapter 9 of the U.S Bankruptcy Code.

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Securities and Exchange Commission Investigation

The United States Securities and Exchange Commission ("SEC") requested the Authority information about bond issuances series 2012A, 2012B and 2013A dating back to fiscal years 2012 and 2013. The Authority has cooperated in the inquiry, including providing the SEC with documents and information. The SEC has also sent what is known as Wells letter notifications to the Authority as well as to investment bankers, financial advisors and legal advisors who helped structure all the related bond issuances under the scope of the its investigation. Wells letters notifies the recipient that is being investigated by the SEC and presents an opportunity for all recipients of such notifications to respond to any allegations from the SEC. The SEC has advised that the information requests should not be construed as an indication that any violation of the federal securities laws has occurred. The Authority has cooperated with the SEC's investigation of bond issuances series 2012A, 2012B and 2013A. As of the date of the financial statements, it cannot be predicted when the SEC's investigation will conclude or what the ultimate outcome will be.

U.S. Internal Revenue Service Examinations

The United States Internal Revenue Service (the "IRS") issued several letters dated from February 7, 2019 to March 28, 2019 to the Authority, to inform that the IRS is conducting certain investigations. The investigations are related to certain Forms 8038-CP Return for Credit Payments to Issuers of Qualified Bonds, as defined by the IRS, and Series YY and EEE bond issuances.

The Authority intends to respond to all correspondences from the IRS and intends to continue to cooperate with the IRS in connection with the above referenced examinations and are working with their representatives to respond to these IRS examinations in a timely manner.

Interest-Rate Swap Agreements

The Authority entered into pay-fixed and receive-variable interest-rate swap agreements as a cash flow hedge of interest rate risk on certain of the Series UU Bonds. At June 30, 2017, the following is the information on the derivative instruments outstanding (in thousands):

<u>Item</u>	<u>Effective Date</u>	<u>Maturity Date</u>	<u>Terms</u>	<u>Counterparty Credit Rating</u>	<u>Notional Amount</u>
A	May 3, 2007	July 2029	Pay 4.08%; receive 67% 3M LIBOR + 0.52%	Aa2/A+	\$ 169,532
B	May 3, 2007	July 2029	Pay 4.08%; receive 67% 3M LIBOR + 0.52%	Aa2/A+	83,343
					<u>\$ 252,875</u>

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Derivative instruments A and B hedge changes in cash flows of the underlying bonds - floating rate notes with coupons based on 5-year SIFMA or 67% of 3-month LIBOR index, and maturities equal to the maturities of the corresponding swaps. As such they are considered hedging derivative instruments. As of June 30, 2017, the negative fair values of the derivative instruments amounts to \$48.1 million.

The following tables include summary information for the Authority's effective hedges related to the outstanding interest rate swap agreements for fiscal year ended June 30, 2017 (in thousands):

Change in Fair Value		Fair Value		Notional
Classification	Amount	Classification	Amount	
Deferred Outflows	\$ (20,778)	Fair value of derivative instruments	\$ (48,132)	\$ 252,875

The terms and fair values of the outstanding interest-rate swaps as of June 30, 2017, were as follows (in thousands):

Associate Power Revenue Bonds	June 30, 2017	Effective Date	Maturity Date	Fixed rate	Fair Value
Libor Bonds, Series UU	\$ 169,532	May 3, 2007	July 1, 2029	4.08%	\$ 32,079
Muni-BMS Bonds, Series UU	83,343	May 3, 2007	July 1, 2029	4.08%	16,053
Total	\$ 252,875				\$ 48,132

The notional amounts of the swaps match the principal amounts of the associated Power Revenue Bonds.

During fiscal year 2017, the payments of fixed rate interest from the Authority exceeded the amount received as variable interest rate from swap counterparties by \$7.7 million.

Using rates as of June 30, 2017, debt service requirements of the variable-rate debt and net swap payments, assuming current interest rates remain the same for their term. These debt service requirements are included in the scheduled maturities of long-term debt disclosed further in this note. As rates vary, variable-rate bond interest payments and net swap payments will vary.

Fiscal year Ending June 30,	Principal	Interest	Interest-Rate Swap, net	Total
(in thousands)				
2018	\$ -	\$ 2,374	\$ 7,943	\$ 10,317
2019	-	2,374	7,943	10,317
2020	-	2,374	7,943	10,317
2021	-	2,374	7,943	10,317
2022	-	2,374	7,943	10,317
2023-2027	-	11,870	39,716	51,586
2028-2029	252,875	4,748	15,887	273,510
Total	\$ 252,875	\$ 28,488	\$ 95,318	\$ 376,681

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As of June 30, 2017, the swaps had a negative fair value of approximately \$48.1 million. The negative fair value of the swaps may be countered by a reduction in future net interest payments required on the variable-rate Power Revenue Bonds, creating higher synthetic rates.

As of June 30, 2017, the Authority was not exposed to credit risk because the swaps had a negative fair value. However, should interest rates change and the fair value of the swap become positive, the Authority would be exposed to credit risk in the amount of the derivative's fair value. The swaps counterparties were rated Aa2 as issued by Moody's Investors Service (Moody's), A+ by Standard & Poor's (S&P), and AA by Fitch Ratings.

The swap agreement uses the International Swaps and Derivatives Association, Inc. Master Swap Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Authority or the counterparties may terminate the swaps if the other party fails to perform under the terms of the contracts. Also, the swaps may be terminated by the Authority if the counterparties' credit rating falls below Baa1 as determined by Moody's or BBB+ as determined by S&P. If at the time of termination, the swap has a negative fair value, the Authority would be liable to the counterparty for a payment equal to the swap's fair value.

The Authority and GDB maintain an agreement for a \$150 million revolving line of credit to meet collateral posting requirements from the 2008 basis and interest rate swaps. As of June 30, 2017, there was a \$35.1 million outstanding balance in this line of credit. This balance is mainly related to the amounts paid under the termination agreements of the swap.

Defeasance of debt

In prior years, the Authority has refunded in advance certain Power Revenue Bonds and other obligations by placing the proceeds of new debt in an irrevocable trust to provide for future debt service payments on such bonds. Accordingly, the trust accounts, assets, and liabilities for the defeased bonds are not included in the Authority's financial statements. At June 30, 2017, \$71.3 million of Power Revenue Bonds which remain outstanding were considered defeased.

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13. EMPLOYEES' RETIREMENT BENEFITS

Pension Plan

A. General Information about the Pension Plan

Plan Description

All of the Authority's permanent full-time employees are eligible to participate in the Authority's Pension Plan, a single employer defined benefit pension plan (the "Plan") administered by the Employees' Retirement System of the Puerto Rico Electric Power Authority (the "System"). The System issues a publicly available financial report that includes financial statements and required supplementary information for the Plan. That report can be found in the following link: https://www2.aeepr.com/retiro/informes_financieros.html

If a member's employment is terminated before he becomes eligible for any other benefits under this Plan, he shall receive a refund of his member contribution plus interest compounded annually. The Plan is not subject to the requirements of the Employees Retirement Income Security Act of 1974 ("ERISA").

Benefits Provided

Benefit provisions under the Plan are established by the System's regulation and Authority resolution. Benefits include maximum retirement benefits of 75% of average basic salary (based on the three-highest annual basic salaries) for employees with 30 years of service; with reduced benefits, available upon early retirement. The Plan was amended on October 23, 1992, to provide revised benefits to new employees limiting the maximum retirement basic salary to \$50,000. The Plan was further amended in October 14, 1999, to provide improved retirement benefits to employees with 25 years or more of credited service from January 1, 2000. Disability and death benefits are also provided. Separation benefits fully vest upon reaching 10 years of credited service.

Supplemental benefits were unfunded and such benefits were reimbursed to the System when paid as of December 31, 1999. Effective January 1, 2000, the Board of Trustees of the System approved the transfer of the obligation for supplemental benefits provided by the Authority and not funded through the System (supplemental pension obligations exchanged for forfeited sick leave benefits and the supplemental spousal survivor benefits) to the Retirement System. Also, the Board of Trustees of the System accepted an amortization period for the Plan of 40 years, which commenced on June 30, 1996.

The Authority's employees with over 25 years of service are entitled to exchange accrued sick leave for supplemental pension benefits just to complete merit annuity (30 years of service) and/or be paid in cash the value of such sick leave upon separation from employment.

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The Plans' provisions and benefits in effect as of June 30, 2017, are summarized as follows:

Hire date	Prior to January 1, 1993	On or after January 1, 1993
Benefit formula	75% @ 30 years of services at full retirement	75% is limited to \$50,000 @ 30 years of services at full retirement
Benefit vesting schedule	10 years' service	10 years' service
Benefit payments	Monthly for life	Monthly for life
Retirement age	N/A	55
Monthly benefits, as a % of eligible compensation	Varies by age and years of service	Varies by age and years of service
Required employee contribution rates	9.06%	11.00%
Required employer contribution rates	41.88%	41.88%

Employees Covered

As of June 30, 2017, the following membership were covered by the benefit terms for the Plan:

	<u>Number</u>
Retired participants and beneficiaries currently receiving benefits	12,210
Terminated participants and beneficiaries entitled to benefits but not yet receiving benefits	101
Active participants	<u>6,530</u>
Total	<u>18,841</u>

Contributions

The Authority's contribution rates are determined on an annual basis by the actuarial valuation and shall be effective on July 1, following notice of a change in the rate. Funding contributions for the Plan is determined annually on an actuarial basis as of June 30 by the System. The actuarially determined rate is the estimated amount necessary to finance the costs of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The Authority is required to contribute the difference between the actuarial determined rate and the contribution rate of employees. For the year ended June 30, 2017, the Authority's annual contribution was \$120 million.

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B. Net Pension Liability

The net pension liability as of June 30, 2017, was measured as of June 30, 2016, and the actuarial valuation date was June 30, 2016. Changes in the net pension liability for the year ended June 30, 2017 are presented below.

Actuarial Assumptions

The Authority recognizes annual pension expense and net pension liability in accordance with GASB Statements No. 68, "Accounting and Financial Reporting for Pensions" and GASB Statement No. 71 "Pension Transition for Contributions Made Subsequent to the Measurement Date" (using an annual actuarial valuation conducted by Cavanaugh Macdonald Consulting, LLC). A summary of principal assumptions and methods used to determine the net pension liability is shown below.

The total pension liability measured as of June 30, 2016, was determined using the following actuarial assumptions:

Valuation Date	June 30, 2016
Measurement Date	June 30, 2016
Reporting date	June 30, 2017
Single Equivalent Interest Rate	
Long-term expected rate of return	5.75%
Municipal Bond Index Rate	2.71%
Fiscal year in which Plan's	
Fiduciary net position is projected to be	
depleted from future benefits payments for	
current members	2026
Single Equivalent Interest Rate	2.93%
Actuarial Assumptions:	
Discount Rate	2.93%
Inflation	2.25%
Payroll Growth	0%
Salary Increase	2.5% to 7.25%, including inflation
Investment Rate of Return	5.75%
Percentage Married	100% of employees, and wives are
	assumed to be 4 years younger
	than their husbands

Mortality Assumptions

The mortality rates were based on RP-2014 Employee Mortality Projected to 2018 using Scale BB, set back one year for males for actives and healthy annuitants and RP-2014 Disabled Mortality projected to 2018 using Scale BB for disabled annuitants.

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Participation

All employees participate. Each member participates under an optional regimen of benefits supplementary to or coordinated with Social Security. All members hired after September 30, 1990, can only participate in the supplementary scheme.

Compensation

Average of the three highest annual base salaries. For new members hired on or after January 1, 1993, annual compensation is limited to \$50,000.

Merit Annuity

Eligibility: For members hired before January 1, 1993, 25 to 30 years of service. For members hired on or after January 1, 1993, there is a minimum age requirement of 55 years of age and 30 years of service. For this group, reduced benefits payable with less than age 55 are effective January 1, 2015.

Basic (Supplementary) Benefit: Life annuity of 2.5% of compensation times years of service up to 30.

Coordinated Benefit: Up to Age 65 = Basic (Supplementary) Benefit. After Age 65 = Basic (Supplementary) Benefit minus \$40 for each year of service up to 30.

Maximum Benefit: 75% of compensation. The maximum is applied to all pensions paid by the System.

Accrued Benefit

Basic (Supplementary) Benefit: 1-1/2% of compensation for each year of service, plus 1/2% of compensation for each year of service after 20 years.

Coordinated Benefit:

Up to Age 65 = Basic (Supplementary) Benefit.

After Age 65 = Basic (Supplementary) Benefit minus \$19 for each year of service up to 30.

Age Retirement

Eligibility: 60 years of age with at least 5 years of service.

Supplementary Pension: Life annuity of basic (supplementary) benefit.

Coordinated Pension: Life annuity of basic (supplementary) benefit until age 65 and coordinated benefit thereafter.

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Actuarial Equivalent (Service) Retirement

Eligibility: 20 years of service.

Supplementary Pension: Immediate life annuity of actuarial equivalent value to basic (supplementary) benefit.

Coordinated Pension: Immediate life annuity of basic (supplementary) benefit until age 65 and of actuarially equivalent value to the coordinated benefit after age 65.

Actuarial Equivalent: Benefit of equivalent value to a deferred life annuity payable from age 60 until death.

Separation Pension

Eligibility: Any age with at least 10 years of service.

Supplementary Pension: Deferred life annuity, payable at age 60, consisting of a basic (supplementary) benefit.

Coordinated Pension: Deferred life annuity, payable at age 60, consisting of a basic (supplementary) benefit until age 65 and of the coordinated benefit thereafter.

Disability Pension

Eligibility: Any age with at least 5 years of service (10 years of service if hired after December 31, 1992).

Regular Benefit: If eligible for a retirement pension or merit annuity, such applicable amount.

Alternative Benefit: If not eligible for a retirement pension or merit annuity, will receive:

- Supplementary Pension - the greater of 90% of the basic (supplementary) benefit or 20% of Final Average Compensation.
- Coordinated Pension: Up to Age 65: Supplementary Pension Benefit - After Age 65: Supplementary Pension Benefit minus \$17.10 for each year of credited service. The resulting benefit cannot be less than 17.5% of Final Average Compensation.

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Death Benefit

Benefit: Lump sum payment equal to the last salary at the time of retirement from active service or death in active service. The lump sum payment may be reduced in certain situations as described below.

Eligibility: Participants with all credited service with the Authority and age 60 with 15 years of credited service or under age 60 with 20 years of credited service at retirement date or death in active service. Receive the full benefit. Members that comply with the age and service requirements have the option to receive payment while in active service. Members who elect to receive their death benefit early will have an increase in their employee contribution rate.

Retirees with age 60 and less than 15 years of service or under age 60 with less than 20 years of service. The benefit will be based on a proportion of actual years of service and corresponding requirement of service according to age.

Retirees with combined credited service from the Authority and other government agency. The benefit will be based on compensation from the Authority and the other government agency.

Disability with less than 5 years of service (10 years for members hired after December 31, 1992). The benefit is proportionally reduced over 5 or 10 years depending on the hired date.

Survivor Benefit

The surviving spouses of retired members receiving a pension benefit will receive a life annuity equal to 30% of the annual pension payable to the member at the time of death.

Employee Contributions

Employee contributions are generally 9.06% of salary.

Employees who elect to receive prompt payment of their death benefit contribute 10.31% of salary if no additional death benefit is payable at retirement and 13.86% of salary if the increase in salary is payable at retirement. The employee pays the higher contribution rate from the time the early death benefit is paid until retirement. For new members, on or after January 1, 1993, employee contributions are 11% of salary.

For supplementary members said contributions are applied to the System. For coordinated members, the part equivalent to 4% of salary up to \$4,200, is included as part of the employee contribution to Social Security, and the remainder is applied to the System.

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Refund of Employee Contributions

The employee contributions dedicated to the System will be reimbursed, with interest at a rate of 5%, as follows:

- A. Upon death in active service.
- B. Upon separation of a member not entitled to a benefit.
- C. Optionally upon separation, instead of a deferred benefit, or upon death before retirement.
- D. Upon death after commencement of a pension. Reimbursement includes the part in excess of the installments already received, if the member has not elected an optional benefit.

Cost-of-Living Adjustment

- A. Increase effective July 1, 1992, to all pensions granted on or before June 30, 1990, as follows:
 - 1. 8% increase for the monthly pension up to \$300.
 - 2. 4% increase for the monthly pension between \$300 and \$600.
 - 3. 2% increase for the monthly pension in excess of \$600.
- B. The minimum monthly increase will be \$25 and the maximum \$50.
- C. Actuarial pensions will be granted the minimum increase of \$25 per month if they were granted on or before June 30, 1990.
- D. These increases, under the same conditions, will be granted automatically every three years beginning July 1, 1992, or from the retirement date for all those who retire after June 30, 1990.

Annual Christmas Bonus

Effective with the June 30, 2002 actuarial valuation, an annual \$300 Christmas bonus is payable to all current and future retirees and beneficiaries. Effective with the June 30, 2003 actuarial valuation, an additional annual \$100 Christmas bonus is payable to all current and future retirees and beneficiaries, for a total of \$400 per year.

Summer Bonus

Effective with the June 30, 2003 actuarial valuation, an annual \$100 summer bonus is payable to all current and future retirees and beneficiaries.

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Funeral Benefit

Effective with the June 30, 2004 actuarial valuation, a lump sum Funeral Benefit of \$1,000 is payable to all current and future retirees.

Notes to Summary of Benefit Provisions

The System became effective as of July 1, 1945, and includes the general fund for regular benefits among others. The valuation only covers the liabilities of the general fund.

Certain provisions of the Rules and Regulations are not described in the summary because of little applicability, for example, variations in formulas when annual compensation is below \$5,000, or with respect to members whose service is before July 1, 1973. In general, if a member has the right to two comparable benefits, he will receive the greater, not both.

There are optional forms of pensions with actuarial adjustments. No additional cost is assumed with respect to optional benefits with actuarial adjustments. It is assumed that members severed before retirement will elect to leave their contributions in the System and will not elect to pay for the death benefit.

Discount Rate

The discount rate used to measure the total pension liability was 2.93%. The projection of cash flows used to determine the discount rate assumed that members contribute the mandatory contribution rate and the Employer will contribute the average employer contribution over the five-year period ended June 30, 2017, which is \$120 million. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members until the plan year ending June 30, 2026. Therefore, the long-term expected rate of return on pension plan investments of 5.75% was applied to all periods of projected benefit payments through June 30, 2026 and the applicable municipal bond index rate of 2.71%, based on the S&P Municipal Bond 20 Year High Grade Rate Index as of June 30, 2016, was applied to all periods of projected benefit payments after June 30, 2026. The Single Equivalent Interest Rate ("SEIR") of 2.93% that discounts the entire projected benefit stream to the same amount as the sum of the present values of the two separate benefit payments streams was used to determine the total pension liability as of June 30, 2016.

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The long-term expected rate of return on pension System investments was determined using a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected returns, net of pension System investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

Periods of projected benefit payments - Projected future benefit payments for all current System members were projected through 2125.

The target asset allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Long-Term Expected Real Rate of Return
Core Bonds	30.0%	2.80%
U.S. Large Cap Equity	22.0%	7.59%
U.S. Small Cap Equity	10.0%	8.85%
International Developed Equity	15.0%	8.57%
Emerging Market Equity	5.0%	9.86%
Long/Short Equity	8.0%	6.33%
Private Equity	5.0%	10.22%
Core Real Estate	5.0%	5.97%
Total	100.0%	

C. Changes in the Net Pension Liability

The changes in the net pension liability for the Plan follows (in thousands):

	Increase/(Decrease)		
	Total Pension Liability	Plan Fiduciary Net Position	Net Pension Liability
Balance at June 30, 2015	\$ 4,921,032	\$ 1,317,230	\$ 3,603,802
Changes for the year:			
Adjustment to beginning Plan net position	-	-	-
Service cost	79,928	-	79,928
Interest	209,459	-	209,459
Differences between expected and actual experience	(19,815)	-	(19,815)
Changes in assumptions	947,510	-	947,510
Contributions - employer	-	113,384	(113,384)
Contributions - employee	-	26,470	(26,470)
Net investment income	-	18,700	(18,700)
Benefit payments, including refunds of employee contributions	(255,825)	(255,825)	-
Administrative expenses	-	(385)	385
Other changes	-	(3,820)	3,820
Net changes	961,257	(101,476)	1,062,733
Balance at June 30, 2016	\$ 5,882,289	\$ 1,215,754	\$ 4,666,535

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Sensitivity of the Net Pension Liability to Changes in the Discount Rate

The following presents the net pension liability of the System, calculated using the discount rate of 2.93 percent, as well as what the System's net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (1.93 percent) or 1 percentage point higher (3.93 percent) than the current rate (in thousands):

		<u>Miscellaneous</u>
1% Decrease		1.93%
Net Pension Liability	\$	5,559,604
Current Discount Rate		2.93%
Net Pension Liability	\$	4,666,535
1% Increase		3.93%
Net Pension Liability	\$	3,945,544

Pension Plan Fiduciary Net Position - Detailed information about pension plan's fiduciary net position is available in the separately issued Retirement System financial report of the System.

D. Pension Expense, Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

For the year ended June 30, 2017, the Authority recognized pension expense of approximately \$812.1 million. At June 30, 2017, the Authority reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

Deferred outflows of resources:	
Difference between expected and actual experience	\$ 23,380
Employer contributions subsequent to the measurement date	120,272
Net difference between projected and actual earnings on plan investments	37,515
Changes of assumptions	<u>1,360,576</u>
Total deferred outflows of resources	\$ <u>1,541,743</u>
Deferred inflows of resources:	
Changes in assumptions	\$ 32,482
Net difference between projected and actual earnings on plan investments	<u>14,861</u>
Total deferred inflows of resources	\$ <u>47,343</u>

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Contributions of \$120.3 million were reported as deferred outflows of resources resulting from a contribution subsequent to the June 30, 2016 measurement date and will be recognized as is a reduction in the net pension liability in the year ended June 30, 2017.

The amounts reported as deferred outflows of resources (other than the contributions after the measurement date and before year end) and deferred inflows of resources related to pensions will be recognized in pension expense as follows (in thousands):

<u>Year Ending June 30,</u>	<u>Amount</u>
2018	\$ 617,219
2019	499,516
2020	246,675
2021	10,717

Other Post-Employment Benefits (OPEB)

Post-Employment Health Plan

Plan Description - PREPA Retired Employees Healthcare Plan ("Health Plan") is a single-employer defined benefit healthcare plan administered by the Authority. The Health Plan for all retirees is capped at \$300 per member per month for retirees and spouses under age 65 and \$200 per member per month for retirees and spouses age 65 and over.

Membership - During fiscal year 2010, the Health Plan changed to require all new retired employees on or after September 1, 2009, to have 30 years of services to receive health benefits. Certain retired employees on or after September 1, 2009, all retired employees before September 1, 2009, are eligible to participate in the Postretirement Health Plan. To remain eligible for participation, Medicare eligible retired participants and their spouses must enroll in Medicare Part B at age 65, or whenever eligible, at their own expenses. The benefit provisions to retired employees are established and may be amended by the Authority.

Funding Policy and Annual OPEB Cost - The required contribution is based on projected pay-as-you-go financing requirements. The contribution requirements of plan members and the Authority are established and may be amended by the Authority.

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The Annual OPEB Cost is calculated based on the Annual Required Contribution ("ARC") of the employer, an amount actuarially determined. The ARC represents a level of funding that, if paid on ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities over a period not to exceed thirty years. The following table shows the components of the Authority's annual OPEB cost for year ended in June 30, 2017 (in thousands):

Annual OPEB cost	\$ 27,048
Actuarial Accrued Liability (AAL)	\$ 408,043
Unfunded AAL	\$ 408,043
Funded Ratio	0.0 %
Annual Covered Payroll	\$ 305,718

The net OPEB obligation change is as follows (in thousands):

Change in net OPEB obligation:

Net OPEB obligation, beginning balance	\$ 117,053
Total annual required contribution (ARC), July 1- June 30	29,271
Interest on Net OPEB obligation	3,664
Adjustments to annual required contribution	(5,888)
Actual benefit payments, July 1-June 30	(20,287)
Net OPEB obligation, ending balance	\$ 123,813

For the fiscal year ended June 30, 2017, the Authority's annual OPEB expense was \$29 million. This expense is included in administrative and general expenses.

The Authority's annual OPEB cost, and the net OPEB obligation for 2017 and the two preceding years were as follows (in millions):

<u>Fiscal Year Ended</u>	<u>Annual OPEB Cost</u>	<u>Percentage of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
June 30, 2015	\$19.6	103%	\$111.8
June 30, 2016	\$27.1	93%	\$117.1
June 30, 2017	\$27.0	92%	\$123.8

OPEB Actuarial Valuation - The Authority's Other Post-Employment Benefits Program actuarial valuation was performed in accordance with GASB Statement No. 45 requirements.

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Actuarial Methods and Assumptions:

Actuarial Valuation Date	July 1, 2014
Actuarial Cost Method	Projected Unit Credit
Amortization method	Level dollar, Open
Remaining Amortization Period	30 years
Actuarial Assets Valuation Method	Market Value of Assets
Investment Rate of Return	3.13% (includes inflation rate)
Inflation Rate:	2.25%
Medical	Not applicable
Prescription drug	Not applicable
Dental	Not applicable
Projected Salary Increases	0%

The required schedule of funding progress included supplementary information (Schedule I) that presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

The actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

14. INDEFEASIBLE RIGHT TO USE AGREEMENTS

Indefeasible right of use ("IRU") agreements are permanent contractual long term agreements, between PREPA Networks, LLC as the owner of the communications system, and the customer, where the agreed upon consideration is received in advance by PREPA Networks, LLC.

On November 28, 2011, PREPA Networks, LLC entered into a ten (10) year Indefeasible IRU purchase agreement with the Puerto Rico Aqueduct and Sewer Authority ("PRASA"). The agreement grants PRASA an IRU for the fiber optic communications network controlled by PREPA Networks, LLC. Pursuant to the purchase agreement, PRASA agreed to pay PREPA Net a total of \$13.7 million through ten (10) incremental annual payments. Amount recognized as deferred inflows of resources is amortized on a straight-line basis over the life of the agreement. As of and for the year ended June 30, 2017, accounts receivable, deferred inflows of resources and revenues related to this agreement were approximately \$6.4 million, \$6.1 million and \$1.4 million, respectively.

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On December 10, 2010, PREPA Networks, LLC entered into a twenty (20) year IRU purchase agreement with MCI International, Inc. ("Verizon"). The agreement grants Verizon an IRU for the fiber optic communication network controlled by PREPA Net. Pursuant to the purchase agreement, Verizon agreed to pay PREPA Networks, LLC a total of \$2.2 million within 45 days of the effective date, plus a one-time fee of \$100,000. In addition, Verizon agreed to pay an annual recurring fee of \$27,300 which is payable within 45 days after the anniversary of the contract effective date. The \$2.3 million contract amount was recorded as accounts receivable and deferred inflows of resources at the contract inception date and amortized on a straight-line basis over the life of the agreement. As of and for the year ended June 30, 2017, deferred inflows of resources and revenues related to this agreement amounted to approximately \$1.5 million and \$110 thousand, respectively.

15. OTHER DEFERRED INFLOWS OF RESOURCES

Other deferred inflows of resources as of June 30, 2017, were as follows (in thousands):

Deferred inflows related to IRU of PREPA Holdings, LLC	\$ 7,535
Deferred inflows related to contributions made by clients for specific projects	<u>4,441</u>
Total	<u>\$ 11,976</u>

16. REVENUES FROM MAJOR CLIENTS AND RELATED PARTIES

Net operating revenues from major clients and related parties during the year ended June 30, 2017 are as follows (in thousands):

Commonwealth of Puerto Rico and components units	\$ 437,759
Municipalities	<u>178,942</u>
Total	<u>\$ 616,701</u>

17. LEASES

Operating Lease

On April 8, 2016, PREPA Networks, LLC entered into a lease agreement covering certain space of one of the buildings owned by PREPA Networks, LLC, for a term of 20 years. The lease agreement calls for monthly rental installments of approximately \$27.9 thousands. The agreement provides for a rent-free period of 150 days, commencing on the date of tenant shall accept the possession of the premises. Effective date of the operating lease is November 4, 2016. Rental income for the fiscal year ended June 30, 2017 amounted to approximately \$323 thousands.

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The schedule of the future minimum annual rentals thereon as of June 30, 2017, are as follows (in thousands):

<u>Year ending June 30,</u>	<u>Amount</u>
2018	\$ 336
2019	336
2020	336
2021	336
2022	336
2023-2027	1,680
2028-2032	1,680
2033-2036	1,453
Total	<u>\$ 6,493</u>

Lease Commitments

The Authority has entered in rental lease commitments for the use of local buildings and land. These agreements are scheduled to expire from 2018 to 2022. Rent expense for the year ended June 30, 2017, amounted to approximately \$5.7 million, and is included as administrative and general expenses in the accompanying statement of revenues, expenses and changes in net position (deficit).

The schedule of the future minimum payments thereon as of June 30, 2017, are as follows (in thousands):

<u>Year ending June 30,</u>	<u>Future minimum payments</u>
2018	\$ 2,672
2019	1,558
2020	1,009
2021	694
2022	<u>121</u>
Total	<u>\$ 6,054</u>

PREPA Networks, LLC leases a communication station under a non-cancelable lease agreement payable in monthly installments of approximately \$30.3 thousand, through December 31, 2017. The future minimum lease payments all of which are due during the fiscal year ending June 30, 2018, is approximately \$182 thousand.

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18. COMMITMENTS AND CONTINGENCIES

Power Purchase Agreements

Power purchase agreements as of June 30, 2017, were as follows (in thousands):

	<u>Authority Share</u>	<u>Type</u>	<u>Capacity (MWs)</u>	<u>Outstanding Commitment</u>
AES Puerto Rico	100 %	Coal	454	\$ 3,033,040
EcoEléctrica	100 %	Gas	507	1,689,566
Humacao Solar Project, LLC	100 %	Renewable	40	469,682
Pattern Santa Isabel, LLC	100 %	Renewable	95	418,198
Oriana Energy, LLC (Yarotek)	100 %	Renewable	45	384,634
San Fermín Solar Farm, LLC	100 %	Renewable	20	143,894
AES Ilumina, LLC	100 %	Renewable	20	133,722
Punta Lima Wind Farm, LLC	100 %	Renewable	26	130,408
Horizon Energy, LLC	100 %	Renewable	10	117,109
Coto Laurel Solar Farm, Inc.	100 %	Renewable	10	105,688
Landfill Gas Technologies of Fajardo, LLC	100 %	Renewable	2	29,086
Windmar Renewable Energy, Inc.	100 %	Renewable	2	15,577
Landfill Gas Technologies of Fajardo, LLC	100 %	Renewable	2	15,519
Total				<u>\$ 6,686,123</u>

The Authority does not have ownership of any assets related to these agreements. As costs are paid each year, they are recorded as purchased power expense. During the year ended June 30, 2017, the Authority paid \$728.9 million for the purchase power commitments. These agreements are scheduled to expire from 2022 to 2044. The outstanding commitment above is a projected cost based on the different variables included in the agreed upon terms through the remaining duration of the power purchase agreements.

Environmental Matters

Facilities and operations of the Authority are subject to regulation under numerous Federal and Commonwealth environmental laws, including the Clean Air Act, Clean Water Act, Oil Pollution Act ("OPA"), Resource Conservation Recovery Act ("RCRA"), Comprehensive Environmental Response, Compensation and Liability Act ("CERCLA") and Underground Storage Tanks, among others. The Authority monitors its compliance with laws and regulations and reviews its remediation obligations on an ongoing basis.

In February 1992, the Environmental Protection Agency ("EPA") conducted a multimedia inspection of the Authority's facilities and identified several alleged instances of noncompliance. The Authority and the EPA negotiated and signed a consent decree, to resolve the issues regarding the deficiencies observed during the inspection and to ensure future compliance with all applicable laws and regulations. The consent decree requires that the Authority improve and implement compliance programs and operations to ensure compliance with environmental laws and regulations.

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In 2004, the United States federal court approved a modification to the consent decree in which the Authority reduced the sulfur content in the No. 6 fuel oil used in certain generating units of its Costa Sur, Aguirre, Palo Seco and San Juan Power Plants. Additionally, the Authority has completed a nitrogen oxide emissions reduction program and modified the optimal operating ranges for all its units under the consent decree.

The Authority believes to be in substantial compliance with the consent decree programs. On July 22, 2014, representatives from the Authority, EPA and United States Department of Justice ("DOJ") met to discuss towards the termination of some of the Programs. As a result, the EPA and the DOJ requested the Authority to submit information regarding the Authority's compliance with the Programs for their review and evaluation. On September 25, 2014, the Authority met again with EPA and DOJ representatives and submitted the information requested, along with a letter where the Authority formally requested the EPA to review and approve the termination of those programs/provisions of the consent decree and its Modification of 2004 presented, as well as begin the process toward jointly filing in the Court a stipulation for Partial Termination of such programs.

To accomplish this goal, the Authority suggested to appoint a task force composed of EPA and the Authority representatives to schedule and meet to address the details which EPA Agreed to. Since May 2018, and as of the date of these financial statements, task force meetings between the Authority and EPA have been held, and a draft of the document is being reviewed by EPA and DOJ. Once the document is final it has to go through a public process for its final approval.

Other Proceedings

Administrative Order Consent ("AOC")

In 1997, as a result of an inspection by the EPA and the Puerto Rico Environmental Quality Board (the "EQB") at the Authority's Palo Seco Power Plant, the EPA issued an Administrative Order for the investigation and possible remediation of seven areas identified by the EPA at the Palo Seco Power Plant and the Palo Seco General Warehouse ("Depot"). On April 19, 2012, the Authority submitted, for EPA's review and approval, the final report letter for the AOC. On August 13, 2012, EPA notified the Authority, that the final report was reviewed and determined that the work required pursuant the AOC has been fully carried out in accordance with its terms. Also, the letter indicated that the notification shall not affect any continuing obligation of respondents, including but not limited to the reimbursement of EPA response costs, as specified in the AOC.

Based on the findings of the remedial investigation, the Human Health Risk Assessment, the Screening Level Ecological Risk Assessment and the AOC, "NO ACTION" recommendation under the Comprehensive Environmental Response Compensation, and Liability Act ("CERCLA") for the Authority's Palo Seco site is believed to be protective of human health and environment. The risk assessments indicate that the levels of residual contaminants present at the site fall within EPA's acceptable risk range.

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The AOC established a Reimbursement of Costs condition in which the Authority agreed to reimburse EPA for all costs incurred by EPA in connection to the site.

On September 21, 2015, the Authority and EPA entered into a tolling agreement ("Tolling Agreement"), which specified that the period commencing on September 21, 2015 to July 21, 2016, is not to be included in computing the period of time that the United States has to initiate a lawsuit for response costs. In the Tolling Agreement, the Authority reserves all rights and defenses which it may have, including the running of any statute of limitations. On May 11, 2016, EPA sent the Authority a detailed cost package for the remaining response costs (i.e., those not directly related to the Consent Order) it claims it is owed spanning from 1996 to 2015, which total approximately \$1.5 million. On July 7, 2016, EPA and the Authority signed a First Amendment to the Tolling Agreement to extend initial the Tolling Period until January 21, 2017.

On January 19, 2017, both parties agreed to sign a Second Amendment to the Tolling Agreement to extend the tolling period until April 21, 2017 and allow for additional time to complete the negotiations, prepare and sign a Settlement Agreement for Recovery of Past Response Cost as per Section 122(h)(1) of the CERCLA.

On July 17, 2017, the Settlement Agreement was signed by the Authority requiring to pay to EPA Hazardous Substance Superfund the principal sum of \$1 million, plus additional sum of interest in three annual installments. The first payment of \$333,334 was made on August 9, 2017. The second payment in the amount of \$337,838 was made on May 29, 2018. The third payment is due on August 17, 2019.

Vega Baja Solid Waste Disposal Superfund Site

In 2002, the Authority received a Special Notice Concerning Remedial Investigation/Feasibility Study for Soil at the Vega Baja Solid Waste Disposal Superfund Site. The EPA has identified the Authority and six other entities as "potentially responsible parties", as defined in the CERCLA.

The Authority shall pay EPA all future response costs not inconsistent with the National Contingency Plan. The Authority has not been informed about for these costs and is unable to determine an estimated amount, therefore there is no amount recorded in the financial statements.

On April 10, 2013, an Environmental Escrow Agreement ("EEA") was entered into by and among the GDB, as the escrow agent, the Puerto Rico Land Authority, the Puerto Rico Housing Department and the Authority and the EPA. The EEA was created to serve as financial assurance for the performance of the obligation under the consent decree. On June 24, 2013, the Authority deposited \$400 thousand into GDB escrow account as provided in the consent decree. Accounts and payments in GDB are retained due to the restructuring process. The escrow account is now deposited in a commercial bank.

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The Authority has requested disbursements charged against this account and payments have been processed. All payments required to be charged against this account are to cover projects required by the consent decree, which can be suspended by the contractors resulting in the application of fines for non-compliance as agreed by the parties, this Consent Decree can be terminated upon motion by any party, provided that all public Defendants have satisfied their obligations of payments of Response Cost and Stipulated Penalties. Termination of this Consent Decree shall not affect the Covenants Not to Sue including all reservations pertaining to those covenants and shall not affect any continuing obligation of the Settling Defendants.

Construction and Other Commitments

As of June 30, 2017, the Authority has commitments of approximately \$178 million in active construction, maintenance and engineering services contracts.

Compliance Programs

The Authority continues to develop and implement a comprehensive program to improve environmental compliance. These programs have been and continue to be updated to conform to new regulatory requirements.

Air Quality Compliance

The Authority is consistently maintaining a 99% or better level of compliance with in stack opacity requirements. The Authority continues to use No. 6 fuel oil with sulfur content of 0.5% or better in its San Juan, Palo Seco and Aguirre Power Plants. In the case of the Costa Sur power plant, Units 5 and 6 have been converted to use natural gas and are currently operating on a dual fuel scenario.

Mercury and Air Toxics Standards (MATS)

The Mercury and Air Toxics Standard ("MATS") establishes national emission standards for hazardous air pollutants ("NESHAP") limits and work practice standards for pollutants emitted from coal and oil fired electric utility steam generating units ("EGU"). The MATS applies to new, reconstructed or existing coal and oil fired EGUs in continental and non-continental areas (from industry, federal government, state and tribal government). In the case of Puerto Rico, there are fourteen (14) oil fired EGUs affected by the regulation, which are operated and maintained by the Authority.

Owners/operators of units that cannot comply by the initial compliance date of April 16, 2015 can request an additional year (1st year) from the local environmental regulatory agency. In Puerto Rico, according with section 112(i)(3), of the CAA, the EQB has the delegated authority to approve such extension. Owners and operators can also request a second year (2nd year) extension to the EPA for those units that are determined to be critical to the reliability of the electrical system. This is based on the EPA's Enforcement Policy for Use of Clean Air Act Section 113(a) Administrative Orders in Relation to Electric

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Reliability and the Mercury and Air Toxics Standard of December 16, 2011. The first extension was approved for Aguirre Power Plant. MATS Requirements have been affected by the hurricanes Irma and María subsequent to fiscal year. This situation has been addressed through EPA's No Action Assurance ("NAA") and its extensions. In addition, the Authority's Integrated Resource Plan modified the requirements as additional renewable sources of generation and a micro-grid approach concept are in the process of being implemented, which lowers the emission of air pollution.

MATS Compliance Strategy

The Authority initiated the process for requesting an Administrative Order for some of the EGUs affected by the MATS. On April 16, 2013, the Authority submitted an Early Notice of Compliance Plan to the Puerto Rico Planning Board. On May 14, 2013, the Governor of Puerto Rico issued an Executive Order to create an Electrical Reliability Council to evaluate the impact of the MATS implementation strategies and the integration of renewable energy source projects. The Authority has implemented this compliance plan for the MATS emission limit requirements, as well as to address compliance with future air compliance regulations. Continuous compliance of some of the existing applicable units with MATS and future air compliance regulations requires the construction and development of a natural gas supply infrastructure in Puerto Rico. The development and construction of required infrastructure results in the delay of the installation of controls at some of the selected Authority's existing EGUs, such delays also affect other existing EGUs. In the case of Costa Sur Units 5 and 6, the EGUs were converted to use natural gas and Bunker C in a dual fuel scenario. Under MATS classification, they have been designated as Non Continental Liquid Oil Fired EGUs. The infrastructure to supply natural gas to these EGUs is in the EcoEléctrica's Liquefied Natural Gas terminal located in Peñuelas. To comply with the MATS, the Authority elected the filterable particulate matter ("PM") parameter and installed PM continuous monitoring systems in both units. Costa Sur units 5 & 6 are in full compliance with the PM limitation and has also complied with the required notification and reporting requirements. It has also complied with the tune up requirement and the water content in fuel requirement. Units 3 and 4 were designated as Limited Use Liquid Oil Fired EGUs, which entails limiting each unit's operation to less than 8% in a 24 month block period of their respective nameplate heat input capacity, effective on April 16, 2015.

On the Early Notice of Compliance Plan presented to the Puerto Rico Planning Board and EPA, the Authority presented the conversion of the San Juan Units 9 and 10 and Palo Seco Units 3 and 4 as the compliance strategy to follow. Since this strategy requires a source of natural gas, and no source is currently available, the Authority is in conversations with EPA regarding MATS compliance in Palo Seco and San Juan.

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For the rest of the applicable EGUs (San Juan Units 7 and 8, and Palo Seco Units 3 and 4), they were designated as Limited Use Liquid Oil Fired EGUs, which entails limiting each unit's operation to less than 8% in a 24 months block period of their respective nameplate heat input capacity, effective on April 16, 2015. These units are also included in the Authority's conversations with EPA, since they were used beyond the rule requirements for limited use units to maintain the electrical system's stability and reliability.

MATS Requirements have been affected by the hurricanes Irma and María subsequent to June 30, 2017. This situation has been addressed through EPA's No Action Assurance ("NAA") and its extensions. In addition, the Authority's Integrated Resource Plan modified the requirements as additional renewable sources of generation and a micro-grid approach concept are in the process of being implemented, which lowers the emission of air pollution.

NAAQS SO2 Compliance

On January 9, 2018, the EPA published the third round of final area designations under the 2010 SO2 NAAQS. In this round, EPA identified two (2) nonattainment areas located in Puerto Rico, the San Juan Area and the Guayama-Salinas Area. The Clean Air Act requires air agencies to take steps to control pollution in SO2 nonattainment areas.

Those steps may include stricter controls on industrial facilities. State and local governments detail these steps in plans that demonstrate how they will meet the SO2 standard. Those plans are known as state implementation plans ("SIPs"). States have 18 months after the effective date of final designations to develop and submit their plans to EPA. Puerto Rico's SIP must be submitted to EPA on October 2019. Once designated, nonattainment areas are subject to Nonattainment New Source Review requirements. New Source Review is a permitting program for industrial facilities to ensure that new and modified sources of pollution do not impede progress toward cleaner air. Nonattainment areas are required to meet the standard as quickly as possible, but no later than five years after the effective date of final designation, therefore the facilities must be in compliance on May 2023. Six months after that date, EPA must determine whether the area has attained the standard.

QA/QC Continuous Monitoring Program

This program requires quarterly audits to the opacity monitors in the Authority's power plants to insure compliance with the Consent Decree Clean Air Compliance Program. Also, this program requires annual quality assurance audits to the optimization monitors at our power plants in compliance with the consent decree. All these reports have been performed and submitted in compliance with the consent decree stipulations.

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Relative Accuracy Test Audit

A Relative Accuracy Test Audit is a test to validate and certify for a period of one year the plant's Continuous Emission Monitoring Systems equipment for purposes of continuous data collection. Annual reports have been performed and submitted in compliance with the air operation permits requirements.

Clean Air Act Title V Permitting Program

The EQB issued final permits for Palo Seco and Aguirre Power Plants on March and April 2015, respectively. The Authority is still awaiting issuance of a Title V for the San Juan Power Plant, Costa Sur Power Plant, Mayaguez, Cambalache, Dagua, Jobos, Yabucoa Turbine Power Block and Vega Baja turbines. All the requested information has been submitted.

Water Quality Compliance

The Authority prepared and submitted the Aguirre Power Complex Clean Water Act Renewal Application on June 30, 2016. The current Permit is administratively extended until the EPA grants a renewed permit. The Authority uses potable water from the Puerto Rico Aqueducts and Sewer Authority ("PRASA") to generate electricity at the San Juan and Palo Seco Power Plants.

San Juan Power plant has continuous exceedances related to the National Pollutants Discharge Elimination System ("NPDES") Discharge Permit. The issuance of a new NPDES permit for San Juan Power Plant in 2007 and a Water Quality Standards Regulation revision from the EQB in 2003 imposed more restrictive permit limits, which eventually led to the issuance of an Administrative Order ("AO") by the EPA. As a control measure, the Authority developed the San Juan Waste Water Treatment Plant Improvement project approved by the State Revolving Fund, that currently is under construction. The main purpose of this project is the reuse of the Outfalls 002 and 003 processes wastewaters, leaving these discharges as storm water only.

In September 2016, the Authority completed the Phase I of the San Juan Waste Water Treatment Plant Improvement Project. This phase consisted of the reuse of the generating units' feedwater heaters condensations. Phase IV that consists of the acquisition and installation of Microfiltration and Reverse Osmosis Systems that is under construction.

The Authority's power generation, especially steam power plants, requires high volumes of water. In the case of the Aguirre Power Complex ("APC"), this water comes from a water well system owned and operated by the Authority. These water wells supply capacity has been reduced throughout the years due to urban expansion in the Municipality of Salinas, causing salt water intrusion to the aquifer. Considering this, the Authority determined to develop and construct the necessary infrastructure to supply raw water from the Patillas Irrigation Channel to the APC, keeping the current well water

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supply as backup. The raw water will then be treated in the APC using ultrafiltration, reverse osmosis and demineralization methods. Also, the project provides for the reuse of condenser cooling water that is currently discharged thru the APC Outfalls, under the National Pollutant Discharge Elimination System Permit Program ("NPDES Permit Program").

The Authority completed the Phase II (Filtration System Building) in March 2015 of the Water Supply Project from the Patillas Irrigation Channel. Phase III (Retention Ponds Construction) of this project was also completed on February 2017 and Phase I (Pipeline Construction from the Irrigation Channel) was completed on September 2018. Phase IV (Pipeline interconnections inside the plant and water treatment equipment acquisition) is in a bid process.

For the financing of the San Juan Waste Water Treatment Plant Improvement and the Water Supply Project from Patillas Lake Irrigation Channel Projects, the Authority signed two Loan Agreements at 2% interest rate, pursuant to the Commonwealth of Puerto Rico Water Pollution Control State Revolving Fund Program ("SRF Program"). The first one was signed on September 6, 2012 for \$17.6 million and the second one on September 27, 2013 for the amount of \$9.5 million. The September 27, 2013 agreement included a Grant for \$1.5 million.

Regulation under the CWA

The EPA issued Section 316(b) of the CWA final rule in November 12, 2014. This final rule has three (3) components. First, existing facilities that withdraw at least 25 percent of their water from an adjacent water body, exclusively for cooling purposes, and have a design intake flow of greater than 2 million gallons per day, would be subject to an upper limit on the amount of fish allowed to be affected by impingement. To comply with this requirement, each facility is given the option of selecting the technologies that would be best suited to address it or reduce its intake velocity to 0.5 feet per second.

Second, existing facilities that withdraw very large amounts of water, at least 125 million gallons per day, would be required to conduct studies to help their permitting authority determine whether and what site-specific controls, if any, would be required to reduce the number of aquatic organisms drawn into cooling water systems, known as entrainment.

Third, new units that add electrical generation capacity at an existing facility would be required to add technology that is equivalent to closed cycle cooling which may be achieved by incorporating a closed cycle system into the design of the new unit or making other design changes with equivalent results.

The Authority has developed and is in the process of implementing an impingement and entrainment control technology ("Aquatic Filter Barrier") in its Costa Sur Power Plant. This technology includes the verification sampling for impingement and entrainment. The Authority understands it is in compliance with the existing NPDES permit conditions.

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Underground Injection Control Regulation

The Authority prepared a compliance plan to meet the EQB's underground injection control regulations. This plan entails the closing of certain septic systems where sanitary discharges can be connected to the PRASA system. The Authority completed the sampling and analysis of the septic systems at Aguirre. Palo Seco is in the process of preparing specifications for the bid of the systems closings. For the San Juan Power Plant the EQB's asked to perform a Contamination Extension Plan associated with four (4) systems.

Spill Prevention Control and Countermeasures Plan ("SPCCP")

EPA has issued regulations setting forth requirements for prevention of, preparedness for, and response to oil discharges at specific non transportation related facilities. To prevent oil from reaching navigable waters and adjoining shorelines, and to contain discharges of oil, the regulation requires these facilities to develop and implement SPCC Plans, and establishes procedures, methods and equipment requirements.

Pursuant to the terms of the Consent Decree, the Authority was required to implement a Spill Prevention Maintenance and Construction Program ("SPMCP"). This program included major overhauls to dikes and fuel tanks. The Authority has completed all compliance projects under the SPMCP of the Consent Decree, in accordance with the established scope of work.

The Authority has a program to comply with new SPCCP requirements, that addresses the containment of potential leakages from oil containing electrical equipment in its distribution substations. The Authority has implemented the monitoring and inspection requirements under these regulations. The Authority completed the secondary containment (dikes) construction program for those substations located besides waterbodies.

Self-Insurance Health Program

Changes in the balances of the health insurance program (self-insurance risk) incurred but not recorded during fiscal year ended June 30, 2017 were as follows (in thousands):

<u>Beginning Balance</u>	<u>Expense</u>	<u>Payments</u>	<u>Ending Balance</u>
\$ 4,116	\$ 50,582	\$ (50,577)	\$ 4,121

This amount is included in accounts payable and accrued liabilities in the statement of net position (deficit).

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Contingencies

General

The Authority is a defendant or codefendant in numerous legal proceedings, including labor related claims, claims for damages due to electrified wires, failure to supply power and fluctuations in the power supply. The Authority has an estimated accrual liability of approximately \$123 million, to cover such exposure, which is presented in accounts payable in the accompanying statement of net position (net position).

As disclosed in Note 19, Subsequent Events, on July 2, 2017, the Authority filed for a petition for relief under Title III of PROMESA. Accordingly, all claims against the Authority have been stayed until such time the stay is lifted by the federal judge having the Title III Cases.

Under certain circumstances, as provided in Act No. 104 of June 29, 1955, as amended ("Act No. 104"), the Commonwealth may provide its officers and employees, including directors, executive directors and employees of public corporations and government component units and mayors of the municipalities of the Commonwealth, with legal representation, as well as assume the payment of any judgment that may be entered against them. There is no limitation on the amount of the judgment that may be paid under the provisions of Act No. 104 in cases before federal court, but in all other cases the Secretary of Justice of the Commonwealth may determine whether, and to what extent, the Commonwealth will assume payment of such judgment. Although the Authority's directors, executive director and employees are covered by the provisions of Act No. 104, Article 19 of Act No. 104 requires the Authority to cover the costs associated with judgments, expenses and attorneys' fees incurred by the Commonwealth in the legal representation of its directors, executive director and employees. To the extent the Authority is unable to cover these costs and expenses, the Authority would be required to reimburse the Commonwealth from future revenues, as provided by the Secretary of the Treasury of the Commonwealth in consultation with the Authority's board of directors.

Labor-Related Claims

- **Excess Vacation License Claim**

In 1999, the "Unión de Trabajadores de la Industria Eléctrica y Riego" ("UTIER") filed a claim on the Bureau of Conciliation and Arbitrage of the Puerto Rico Department of Labor and Human Resources ("PRDLHR"), against the Authority, for the accrued vacation balances over 450 hours based on the last ten years since July 24, 1989. On September 26, 2012, the Arbiter of the PRDLHR resolved that the claim was applicable to all of UTIER's membership and that the Authority has to pay from 1995 through 2015. On April 17, 2015, the Arbiter issued a judgment which determined that the Authority has been in non-compliance and ordered the Authority to pay claimants the following:

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- a) Two times the corresponding salary for the balances in excess of 60 days that the union employees had or have since August 1, 1995 until the date of the decision based on Act No. 84 of 1995 and Act 180 of 1998.
- b) Should pay to each employee the same amount for the concept of the penalty plus the legal interest since the day of the decision in accordance of Act No. 180 of 1998.
- c) 10% of the attorney's fees

Act No. 17 of April 17, 1931, Sec. 8, as amended, establishes that the penalty to the claim amount should be the same as the amount owed. In addition, since the plaintiff had to file the case to the Court, the total amount owed will be the double of the sum of the claim amount, plus the aforementioned penalty.

On May 18, 2015 the Authority filed a recourse to dispute and dismiss PRDLHR's judgment to the First Instance Court. On April 18, 2016, the First Instance Court determined that the Arbiter's decision was justified based on the facts and documents submitted to the PRDLHR, and therefore, validated the judgment. A request for appeal has been submitted to the Court of Appeals but have been stayed as a result of the filing of the Authority's Title III petition. Management understands that is possible that the Authority will have a significant economic impact arising from Court's decision. The Authority is still contesting this determination, and amounts to be paid are still in the process of estimation.

- **Christmas Bonus**

On December 17, 2014, UTIER presented to the Labor Relations Board of Puerto Rico a claim to the Authority's decision to reduce the Christmas bonus due in December 2014 to \$600, in accordance with Article 11 of Act 66 of June 14, 2014. UTIER claimed that the Act was not effective until July 1, 2014, and therefore, as of June 30, 2014, the December 2014 bonus was already earned. On May 31, 2017, the Hearing Officer issued a recommendation to the Board that the Authority should be ordered to pay the remaining amount of the christmas bonus paid in December 2014.

On July 17, 2017 the Authority submitted an automatic stay motion under Title III petition. Management has estimated that the probable loss, in case if the Authority does not succeed in the defense case, is a liability of approximately \$30.2 million including penalties which is recorded as a liability in the statement of net position (deficit).

In addition, in 2014, a group of the Authority's management employees presented to the Public Service Appeal Commission a claim against the Authority related to the December 2014 christmas bonus, which was reduced to \$600, in accordance with Article 11 of Act 66 of June 14, 2014. The Commission has not issued a resolution in regard to this matter, but the Authority estimated and recognized a loss contingency for \$19.5 million in the statement of net position (deficit), which includes possible penalties. The case has been stayed as a result of the filing of the Authority's Title III petition.

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- **Re-employment Bargaining Agreement Violations**

In May 2010, UTIER submitted to the PRDLHR a total of 171 claims against the Authority, for violations of the collective bargaining agreement. When the Authority recruited new employees, the previously displaced emergency employees kept on waiting list was not considered, as required by the collective bargain agreement. The Arbitrage hearing was held on May 14, 2010. On June 18, 2013 the case concluded that the Authority violated the collective bargain agreement, since it did not gave priority to displaced employees first. The Authority was ordered to pay all the salaries that would have been earned since the new employees were hired.

On August 24, 2015 the Authority began the process to award the amount owed, but the UTIER requested that for this case, the double penalty should be apply, since the claim is salary related. The Authority did not accepted UTIER's penalty claim and submitted the Authority's allegation to the PRDLHR. The case was stayed due to the Title III filing. The Authority recorded a loss contingency for \$18.2 million in the statement of net position (deficit).

- **Mealtime Penalty Claim**

In 1999, the “Unión Insular de Trabajadores Industriales y Construcciones Eléctricas” (“UITICE”) filed a claim on the PRDLHR, against the Authority for payment of salaries for work performed during the period established for meal time, which occurred outside the regular work schedule. The period of the claim was for the period of ten years prior to May 23, 1997 for active employees and the last ten years prior to the retirement date of inactive or retired employees before the three year period before the claim. On December 31, 1997 the UITICE and the Authority signed a stipulation in accordance with Act 41 of 1990. In this stipulation, the Authority would pay a penalty for work performed during mealtime in extraordinary work schedule. In addition, the Authority agreed that the penalty to be paid for the hours worked was going to be computed from the period that the Act 41 of 1990 was effective until the date of the stipulation.

After the agreement, the Puerto Rico Supreme Court resolved another case in which it stated that the right for mealtime existed since 1974. In accordance with the jurisdiction comprised in the stipulation, the UITICE requested an Arbiter, who had jurisdiction in the case, with the purpose of providing retroactive relief in accordance with the Supreme Court's decision. On July 7, 2000 the PRDLHR issued a new decision in which determined that the stipulation signed on December 31, 1997 was not final, and determined that the payment should be retroactive, as per Supreme Court's decision. UITICE filed a motion in the First Instance Court for the compliance of the arbitral award, for which the Court decided against the Authority. Later, the Authority submitted an appeal in the First Instance Court Decision. On February 21, 2017, the Puerto Rico Court of Appeals evaluated UTIER's motion to require payment from the Authority per the First Instance Court's judgement. The Court of Appeals ratified the First Instance Court's decision.

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The approximate liability of the mealtime penalty is \$6.1 million including double penalty related to salary and benefit cases. Such amount has been accrued as a liability in the statement of net position (deficit). The case has been stayed as a result of the filing of the Authority's Title III petition.

- **Other Violations to Collective Bargaining Agreements Provisions**

In 2007, UTIER submitted before the Labor Relations Board of Puerto Rico a claim against the Authority because of multiple violations to collective bargaining agreement provisions since the Authority had left without effect provisions with UTIER from December 11, 2006 thru August 23, 2008. These violations include controversies in change of assigned turn schedules, daily relief for employees on turn and publication of available job positions within the Authority. -

On April 23, 2014, the Labor Relations Board of Puerto Rico resolved that the bargain agreement provisions were valid for the claim period. On July 16, 2014, the Authority filed a motion on the Court of Appeals where the court determined that the decision was correct. The process to determine payment amount was stayed as a result of the filing of the Authority's Title III petition. The Authority has recorded a loss contingency for \$18 million in the statement of net position (deficit).

Capeco Litigation

In 2009, a large fire at a tank farm owned by CAPECO caused major damage to surrounding areas. The Authority stored some of its fuel at this facility. In the aftermath of the fire, numerous claims were filed against CAPECO. Some of the plaintiffs included the Authority as a defendant in these suits, alleging that the Authority failed in its duty (as the owner of fuel stored at the site) to properly monitor CAPECO's operations in the tank farm. All cases are in the initial stages and the Authority intends to vigorously defend against these claims. Discovery proceedings have not yet begun. On August 12, 2010, CAPECO filed for bankruptcy. As a result, all proceedings against CAPECO were stayed. Subsequently, CAPECO'S bankruptcy proceeding ended.

Consumer Billing Litigation

The Authority is a defendant in a legal claim by various consumers claiming damages in excess of \$100 million, allegedly caused by incorrect and unlawful billing and invoices practices, the Authority believes that the cases has no merit and is vigorously contesting the claim.

In the case of Ismael Marrero, et al. v. the Authority, et al., plaintiffs filed class action against the Authority, William A. Clark, Edwin Rodríguez, César Torres, several laboratories, and oil supply companies; claiming that all defendants conspired to violate RICO, with the resulting damages to plaintiffs. According to the complaint, the defendant fuel oil suppliers provided fuel oil to the Authority which failed to meet contractual specifications or failed to comply with EPA specifications, and this was noncompliant.

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The Authority paid the same price for this allegedly cheaper oil that it paid for compliant oil. The Authority accepted the noncompliant fuel oil in exchange for undisclosed kickbacks or commissions from unspecified defendants. Plaintiffs allege they were overcharged on their monthly electricity bills as a result of the alleged RICO conspiracy. Collectively, defendants (including the Authority) filed 14 motions to dismiss. Plaintiffs opposed these. On September 29, 2015, the magistrate Judge issued a Report and Recommendation denying the motions to dismiss. The Authority filed its objection on October 16, 2015. The court bifurcated the case and currently the case is in its class certification discovery phase. The Authority will continue to vigorously defend this case.

Plaintiffs did not claim a specific amount of damages. If Plaintiffs were to prevail on the merits, the determination of the amount of damages to be awarded would depend on expert witness analysis.

The case of *Pedro Santiago v. AEE, et al.*, Civil No. KPE20160618, is a consumer class action against the Authority under 32 L.P.R.A., sec. 3341, also claiming unjust enrichment, damages of up to \$600 million, antitrust violations, and requesting permanent injunction. A proposed class of plaintiffs, all of whom are residential energy consumers, are challenging the fuel adjustment charge and the purchase of energy charge on various grounds, including breach of contract claims. The Authority has answered the complaint and is currently working on a motion to dismiss the case in its entirety. The Authority will vigorously defend the case and maintains that there is no cause of action against the Authority.

Vitol Inc. Litigation

In 2009, the Authority filed suit in the Commonwealth of Puerto Rico Court of First Instance (the "State Court") against Vitol, Inc. and Vitol S.A. (collectively the Vitol) seeking a declaratory judgment as to the nullity of a two fuel supply agreement due to the Vitols' failure to disclose (a) certain corruption criminal charges to which Vitol S.A. pled guilty and (b) various other investigations. The Vitol removed this suit to the U.S. District Court for the District of Puerto Rico ("District Court") and presented a counterclaim alleging that the Authority owed Vitol, Inc. approximately \$45 million, consisting of \$28 million in fuel that was delivered to, and used by, the Authority and approximately \$17 million, for reimbursement of excise taxes, plus interests, costs, and attorney's fees. The Authority requested remand of the case back to the State Court.

On November 28, 2012, the Authority filed a second complaint against the Vitol in State Court seeking essentially the same remedies sought in the first action but as to four other certain contracts, after discovery revealed the date on which the Vitol learned of the investigations in the corruption cases. Vitol also removed this action to the District Court. The Authority requested remand back to State Court.

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The two cases were consolidated. The Authority claims approximately \$3.5 billion in the aggregate. Vitol, Inc. has resolved the claim for the \$17 million in excise taxes and has stated that it will amend its counterclaim to dismiss that claim. Discovery in the case is closed. The parties have submitted motions for summary judgment against each other and the corresponding oppositions and replies thereto. The motions are pending adjudication by the court.

On March 16, 2016, the District Court granted the Authority's requests for remand and remanded both cases to State Court. On April 8, 2016, Vitol appealed to the U.S. Court of Appeals for the First Circuit (the "Court of Appeals") the order remanding the cases to State Court. The Court of Appeals affirmed the order remanding the case to State Court. Vitol requested rehearing by the full court of said ruling and the Court of Appeals denied the request for rehearing as to the Authority's claims but left pending its ruling as to Vitol's counterclaim due to said counterclaim having been stayed as a result of the Authority's petition under Title III of PROMESA. Vitol once again removed the case from the State Court to the District Court but this time pursuant to the Title III provisions.

The Authority has requested legal counsel to represent it in the Title III proceeding to remand the case to the State Court.

Tradewinds Energy Barceloneta LLC and Tradewinds Energy Vega Baja Arbitration

The Authority and Tradewinds Energy LLC entered into two Power Purchase and Operating Agreements ("PPOAs") to develop aeolic (wind) energy facilities, which were assigned to Tradewinds Energy Barceloneta and Tradewinds Energy Vega Baja (collectively Tradewinds). On January 18, 2016, Tradewinds filed a demand for arbitration under the two PPOAs claiming \$30 million in damages. The parties have already selected the arbitrator, but have yet to execute the arbitration submission agreement so that the Authority may proceed to answer the claim for arbitration. The Authority will deny any and all liability to Tradewinds and denies having breached any obligations under the PPOAs. The case has been stayed as a result of the filing of the Authority's Title III petition.

ReSun (Barceloneta) LLC Litigation and Arbitration

ReSun (Barceloneta) LLC (ReSun) and the Authority entered into a Power Purchase and Operating Agreement ("PPOA"). ReSun claims that the Authority breached its obligations under the PPOA and demanded arbitration. The Authority asserted that it did not have to submit to arbitration yet and, on December 30, 2015, ReSun filed a complaint before the State Court to compel the Authority to submit to arbitration.

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The Authority filed a motion for summary judgment to dismiss the complaint to compel and, on April 20, 2016, the State Court granted the Authority's motion and dismissed the complaint to compel arbitration. On June 23, 2016, ReSun appealed the judgment of dismissal. The Authority filed its appellee brief. The Court of Appeals affirmed the summary judgement of dismissal. ReSun filed a petition for certiorari before the PR Supreme Court, which was stayed as a result of the filing of the Authority's Title III petition. Management believes that the case has no merit and no accrual has been made.

PBJL Energy Corporation Litigation

On December 20, 2011, the Authority and PBJL Energy Corporation ("PBJL") entered into a Master Renewable Power Purchase and Operating Agreement ("MPPOA") pursuant to which PBJL, in its discretion, could propose to the Authority solar photovoltaic energy projects pursuant to which, if the Authority's system could interconnect the proposed projects, and the Authority accepted a proposed site and interconnection point, the Authority and PBJL could enter into a Power Purchase and Operating Agreement ("PPOA"). On May 5, 2015, PBJL filed a complaint against the Authority and various employees in their official and personal capacity, claiming that the Authority had an obligation to award PPOAs to PBJL and that the Authority breached its obligations under the MPPOA by refusing to award PPOAs to PBJL under de MPPOA. On June 2, 2015, PBJL filed an amended complaint. On July 30, 2015, PREPA's defendant-employees filed a motion to dismiss the complaint against them in their personal capacities, which was granted by the court. On August 10, 2015, PREPA answered the amended complaint.

PBJL claims damages in the amount of \$211 million. The Authority has denied any liability to PBJL and has asserted that the Authority did not have the obligation to award a PPOA to PBJL under the MPPOA because the same is not a contract, and that, to the extent that the MPPOA is a contract, the same is null and void for lack of consideration and due to PBJL's failure to provide the Authority the sworn statement required by Act 458 of 2000, as amended, among other defenses raised by the Authority in its answer to the complaint. The case was in the stage of discovery proceedings, however, on August 30, 2017 the Puerto Rico Court of First Instance stayed this case due to the Chapter III filing under PROMESA by the Authority.

CMA Builders

This is a cash collection action related to a bid bond furnished with the proposal forfeited in favor of the Authority. It was furnished after CMA was awarded the bid for supplying fuel oil but later failed to enter into a Contract with the Authority. A motion to reconsider was filed before the Puerto Rico Court of Appeals. This was denied by said Appellate Court on May 19, 2017. On June 26, 2017, the Authority filed a Certiorari before the Supreme Court of Puerto Rico. Case is stayed under PROMESA.

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Bodily Injuries Claims

The Authority is a defendant on several legal claims arising from different separate individuals, claiming physical bodily injuries suffered by coming into contact with wires and similar accidents and events. Aggregate claims amount to approximately \$201 million. The Authority has accrued approximately \$7 million as a contingency liability to settle these legal claims, but intends to continue to defend the cases vigorously.

However, on July 2, 2017, the Authority filed for a petition for relief under Title III of the Puerto Rico Oversight Management and Economic Stability Act ("PROMESA"), 48 U.S.C. sec. 2101 et. seq. the Authority filed the notice of stay before the Appeals Court on July 11, 2017.

Tec General Contractors V. The Authority

On July 1, 2015 Tec General Contractors filed a suit due to breach of contract regarding the Rehabilitation of the Guajataca Canal Project. The Authority contracted Architects and Engineers ("CSA") for the preparation of blueprints and project specifications. Once received, the Authority celebrated the bidding process. The project was finally awarded to Tec General Contractors. After works began, the Authority contracted with CSA once again for inspection services during the project. During the project, both the Authority and CSA requested changes to the original project specifications which resulted in material changes to the project and additional costs to Tec General.

After merits trial, judgment was entered against the Authority and CSA jointly for \$1.3 million. The Authority was also found liable for administrative expenses and retainer fee for a total of \$174 thousand. The case was appealed by both the Authority and CSA. On July 19, 2017 the Authority filed Notice of Stay, having filed for a petition for relief under PROMESA on July 2, 2017. The case is currently stayed. Plaintiffs moved for reconsideration for stay as to CSA to be lifted. Both the Authority and CSA have opposed the petition for reconsideration and the same was denied. The Authority will continue to vigorously argue and defend this action. It is reasonably probable that the Authority will not prevail, and this amount has been accrual as part of the estimated liability for legal claims. However, the payment is subject to final judgment and Title III proceedings.

19. SUBSEQUENT EVENTS

Permanent Rate (New Rate Structure)

On May 27, 2016, the Authority submitted a petition before the Puerto Rico Energy Bureau ("PREB") (then known as the Puerto Rico Energy Commission) seeking approval of a new rate structure ("Permanent" Rate) ("permanent" meaning that, after it was implemented, it would remain in effect until changed by a lawful process) in addition to a provisional rate as a transitional measure ("Provisional Rate"). The proposed new rate structure was intended to update the costs associated with producing energy and to implement a transparent bill, also approved by the PREB, under law.

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On June 24, 2016, the PREB approved a provisional uniform rate of 1.299 cents/kWh, which was added to the existing base rate for all PREPA's customer classes. The Provisional Rate came into effect in the first billing cycle of August 2016 and was to be effective until the implementation of a Permanent Rate. PREPA would reconcile the difference between the Provisional Rate and the Permanent Rate in accordance with the provisions of applicable laws and the applicable PREB resolutions and orders.

On January 10, 2017, the PREB issued a Final Resolution and Order, subject to certain later orders, including a March 8, 2017, Final Resolution. The PREB, in its final orders, issued several directives to PREPA, which were addressed through compliance filings. During this process, on May 31, 2017, the PREB ordered PREPA to implement the PREB's approved Permanent Rate by July 1, 2017, in addition to begin following the approved mechanism for reconciling the Permanent Rate with the Provisional Rate with such implementation. Due to certain additional events and information, by means of the Resolution and Order of June 23, 2017, the PREB granted PREPA until October 1, 2017, to implement the Permanent Rate set by the PREB.

However, the passage of hurricanes Irma and Maria affected the administrative, operational, and service processes offered by PREPA, including meter reading, customer billing and the plans for implementation of the Permanent Rate and the reconciliation. Therefore, after considering additional information, through the Resolution and Order of November 1, 2017, the PREB approved the extension of the effectiveness of the Provisional Rate and established that as the restoration of the electric service and its operations progressed, it would determine the appropriate timeline for the implementation of the Permanent Rate. Through the Resolution and Order of November 27, 2018, the PREB ordered PREPA to implement the Permanent Rate by April 1, 2019.

On March 21, 2019, the PREB issued a final Resolution and Order, which granted an additional extension to the implementation date of the permanent rate. On May 1, 2019, the Authority implemented the permanent rate.

Key Legislation Prior to PROMESA

Act 4-2016: The Revitalization Act

On February 16, 2016, the Puerto Rico Electric Power Authority Revitalization Act ("Act 4-2016") was signed into law. Among its purposes, Act 4-2016 is intended to facilitate the transformation of the Authority and its recovery plan. Act 4-2016 sets forth a framework for the Authority to execute agreements with creditors reached to that date. Act-4-2016 also creates the Puerto Rico Electric Power Authority Revitalization Corporation ("PREPARC") with the power to issue securitization bonds to restructure at a discount PREPA's outstanding long-term debt and impose an escalating transition charge on PREPA's customers, the payment of which will be pledged to repay such bonds as contemplated by the 2016 Restructuring Support Agreement (the "2016 RSA") entered into by, among others, the Authority, PREPARC and certain of the Authority's major creditors.

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On April 7, 2016, PREPARC filed a petition before the PREB seeking approval of the calculation methodology for the transition charge and the related adjustment mechanism. On June 21, 2016, PREB approved PREPARC's petition, and on June 28, 2016, PREPARC approved a resolution authorizing the issuance of the new securitization bonds, subject to certain terms and conditions, consistent with the terms of the 2016 RSA.

After the Title III filing, the FOMB, the Authority, AAFAF, and certain of Authority's major creditors negotiated terms of a new restructuring support agreement. On May 3, 2019, (i) the Authority, (ii) AAFAF, (iii) FOMB, (iv) the members of the Ad Hoc Group of the Authority's Bondholders, and (v) Assured Guaranty Corp. and Assured Guaranty Municipal Corp. entered into a Definitive Restructuring Support Agreement (together with the annexes, exhibits and schedules attached thereto, the "2019 RSA"). The 2019 RSA contemplates the issuance of new securitization bonds, payable from a similar transition charge imposed on Authority's customers and certain other electricity users, either through PREPARC or another special purpose issuer in order to restructure at a discount the Authority's outstanding long-term debt. On May 10, 2019, FOMB on behalf of the Authority, asked the Title III court to approve the 2019 RSA, and the request is currently pending. Implementation of the 2019 RSA will likely require enactment of new legislation or conforming amendments to Act 4-2016.

Act 21-2016: The Moratorium Act

On April 6, 2016, the Moratorium Act No. 21-2016 was signed into law. Among other objectives, the Moratorium Act allowed the Governor to declare a moratorium on debt service payments and to stay related creditor remedies against the Commonwealth and its component units for a temporary period.

The Moratorium Act also created a new Commonwealth government agency – AAFAF – to assume GDB's role as fiscal agent, financial advisor and reporting agent for the Commonwealth, its component units, and municipalities.

The Governor issued executive order OE-2016-010, declaring GDB to be in a state of emergency, and implemented a regulatory framework prohibiting loan disbursements by GDB and establishing a procedure with respect to governmental withdrawals, payments, and transfer requests in respect of funds held on deposit at GDB. To that effect, OE-2016-010 restricted the withdrawal, payment and transfer of funds held on deposit at GDB to those reasonable and necessary to ensure the provision of essential services and authorized GDB to establish weekly limits on the aggregate amount of such disbursements. The procedures implemented by OE-2016-010 resulted in restrictions on the ability of the Authority to withdraw any funds held on deposit at GDB.

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The Secretary of the Treasury issued Circular Letter No. 1300-08-17 (“CC 1300-08-17”) alerting the Commonwealth’s agencies and component units with funds deposited with GDB that such deposits were exposed to custodial credit risk as a result of GDB’s liquidity shortage and corresponding insolvency situation. CC 1300-08-17 also reminded the Commonwealth’s agencies and component units that, in light of the Moratorium Act and OE-2016-010, GDB believed there was substantial doubt about its ability to continue as a going concern.

AAFAF’s authority was expanded on January 18, 2017 through the enactment of the Puerto Rico Fiscal Agency and Financial Advisory Act, Act No. 2-2017 (the “AAFAF Enabling Act”). The AAFAF Enabling Act made AAFAF the sole government entity authorized to renegotiate, restructure, and reach agreements with creditors in connection with public debt or any other debt issued by a government entity.

On May 15, 2017, GDB, AAFAF, and the holders of a significant portion of GDB’s debt entered into a Restructuring Support Agreement (as amended, the “GDB RSA”), which sets forth the terms and conditions for a consensual restructuring of GDB’s debt under Title VI of PROMESA. On August 24, 2017, the Government Development Bank for Puerto Rico Debt Restructuring Act, Act No. 109-2017 (the “GDB Restructuring Act”) was signed into law, authorizing GDB to restructure their indebtedness through the creditor collective action procedures under Title VI of PROMESA, which provide an out-of-court process for a consensual debt modification (a “Qualifying Modification”) that requires significant support from affected creditors and final court approval to bind non-consenting creditors.

The GDB and AAFAF began soliciting votes on the Title VI process from certain bondholders on August 9, 2018. The following day, GDB filed an application for approval of the Qualifying Modification with the United States District Court for the District of Puerto Rico (the “Court”). In September 2018, the requisite number of votes were received for creditor approval of the Qualifying Modification; the Title VI action was supported by creditors holding a majority of the \$4.5 billion in claims to be modified under the creditor collective action procedures. A hearing to consider approval of and outstanding objections to the Qualifying Modification was scheduled for November 6, 2018.

The Court entered an order approving the Qualifying Modification on November 7, 2018, the GDB shall remain a legal entity without operations beyond those related to the consummation of the contemplated transactions - both under the proposed Qualifying Modification and those pursuant to the GDB Restructuring Act - and the management of certain assets thereafter.

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PROMESA

On June 30, 2016, President of the United States signed into law the *Puerto Rico Oversight, Management, and Economic Stability Act*, (“PROMESA”). In general terms, PROMESA seeks to provide the Commonwealth with fiscal and economic discipline through, among other things: (i) the establishment of the Financial Oversight Board, whose responsibilities include the certification of fiscal plans and budgets for the Commonwealth and its related entities; (ii) a temporary stay of all creditor lawsuits; and (iii) two alternative methods to adjust unsustainable debt: (a) a voluntary debt modification process under Title VI of PROMESA, which establishes a largely out of court debt restructuring process through which modifications to financial debt can be accepted by a supermajority of creditors; and (b) a quasi-bankruptcy proceeding under Title III of PROMESA, which establishes an in court debt restructuring process substantially based upon incorporated provisions of the U.S. Bankruptcy Code. Each of these elements are divided among PROMESA’s seven titles, as discussed below.

(i) Title I – Establishment of Oversight Board and Administrative Matters

PROMESA established, the Financial Oversight and Management Board to provide a method to achieve fiscal responsibility and access to the capital markets. The Financial Oversight and Management Board is independent from the Commonwealth.

(ii) Title II – Fiscal Plan and Budget Certification Process and Compliance

Sets forth the requirements for proposing and certifying fiscal plans and budgets for the Commonwealth and its component units. The fiscal plan should provide for a sustainable level of debt, improve governance, provide for capital expenditures that promise economic growth, and respect the relative priorities that different classes of bondholders have vis-à-vis one another under Puerto Rico law.

Only after the Financial Oversight and Management Board has certified a fiscal plan may the Governor submit a fiscal year Commonwealth budget and fiscal year budgets for certain Commonwealth component units (as determined by the Financial Oversight and Management Board) to the Legislative Assembly.

In furtherance of the foregoing duties, PROMESA contains a provision that grants the Financial Oversight and Management Board powers to monitor compliance with certified fiscal plans and budgets and undertake certain actions, including spending reductions and the submission of recommended actions to the Governor that promote budgetary compliance.

(iii) Title III – In-Court Restructuring Process

Establishes an in-court process for restructuring the debts of Puerto Rico and other United States territories. On July 2, 2017, the Financial Oversight and Management Board filed a petition under Title III of PROMESA in the United States District Court for the District of Puerto Rico, commencing a Title III case for the Authority.

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In a Title III case, the Financial Oversight and Management Board acts as the representative of the debtor and is authorized to take any actions necessary to prosecute the Title III case. Immediately upon filing the Title III petition, the broad automatic stay of Bankruptcy Code Section 362 (which is incorporated into Title III cases under PROMESA) applies to automatically stay substantially all litigation against the debtor. The commencement of a Title III case does not limit or impair the powers of Puerto Rico to control by legislation or otherwise the exercise of the political or governmental powers of the territory or territorial instrumentality.

(iv) Title IV – Temporary Stay of Litigation, Government Reporting, and Other Miscellaneous Provisions

Contains several miscellaneous provisions, including a temporary stay of litigation related to “Liability Claims,” relief from certain wage and hour laws, the establishment of a Congressional Task Force on Economic Growth in Puerto Rico (the “Task Force”), the requirement that the Comptroller General of the United States submit two reports to Congress regarding the public debt levels of the U.S. territories, and expansion of the federal government’s small business HUB Zone program in Puerto Rico.

Pursuant to PROMESA section 405, the enactment of PROMESA immediately and automatically imposed a temporary stay (the “PROMESA Stay”) from June 30, 2016 (the date of PROMESA’s enactment) through February 15, 2017 of all “*Liability Claim*” litigation commenced against the government of Puerto Rico and its component units after December 18, 2015. A “Liability Claim” is defined as any right to payment or equitable remedy for breach of performance related to “a bond, loan, letter of credit, other borrowing title, obligation of insurance, or other financial indebtedness for borrowed money, including rights, entitlements, or obligations whether such rights entitlements, or obligations arise from contract, statute, or any other source of law related [thereto]” for which the Commonwealth or one of its component units was the issuer, obligor, or guarantor and such liabilities were incurred prior to June 30, 2016. The PROMESA Stay as subject to a onetime 75-day extension by the Financial Oversight and Management Board or a one-time 60-day extension by the district court. On January 28, 2017, the Financial Oversight and Management Board extended the stay by 75 days to May 1, 2017, at which time the PROMESA Stay expired. Any party subject to the PROMESA Stay could have filed a motion in the United States District Court for the District of Puerto Rico seeking a relief from the PROMESA Stay upon “cause shown.” PROMESA § 405(e).

(v) Title V – Infrastructure Revitalization

Title V of PROMESA establishes the position of Revitalization Coordinator under the Financial Oversight and Management Board and provides a framework for infrastructure revitalization through an expedited permitting process for “critical projects” as identified by the Revitalization Coordinator.

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A “critical project” means “a project identified under the provisions of Title V and intimated related to addressing an emergency whose approval, consideration, permitting, and implementation shall be expedited and streamlined

(vi) Title VI – Consensual, Out-of-Court Restructuring Process

Establishes an out-of-court process for restructuring debts.

(vii) Title VII – Sense of Congress

Sets forth the sense of Congress that any durable solution for Puerto Rico’s fiscal and economic crisis should include permanent, pro-growth fiscal reforms that feature, among other elements, a free flow of capital between possessions of the United States and the rest of the United States.

(a) Actions of the U.S. Government, Congress and Oversight Board after the Enactment of PROMESA

1. Oversight Board Public Meetings

Pursuant to PROMESA section 104(a), the Financial Oversight and Management Board periodically holds public meetings to conduct its business and hear testimony regarding key developments in the Commonwealth’s restructuring efforts. The Financial Oversight and Management Board has held public meetings, for a detailed description of the events of each meeting, see the information available on the Financial Oversight and Management Board’s public website located at: <https://oversightboard.pr.gov>

2. Financial Oversight and Management Board Commencement of Title III Cases

On May 1, 2017, the PROMESA stay expired, permitting the substantial litigation brought by bondholders and other creditors against the Commonwealth and its component units to resume. On July 2, 2017, the Financial Oversight and Management Board commenced a Title III case for the Authority by filing a petition for relief under Title III of PROMESA. All of the Commonwealth’s Title III cases have been consolidated for procedural purposes only and are being jointly administered.

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3. Key Contested Motions in the Title III Cases

- Ad Hoc Group of the Authority Bondholders' Stay Relief Motion

On July 18, 2017, certain financial creditors filed a motion seeking to lift the automatic stay in the Authority's Title III case to file an action in the Commonwealth court seeking the appointment of a receiver for the Authority to oversee certain operations of the utility company, and to seek an increase in rates.

On September 14, 2017, Judge Swain denied the Ad Hoc Group of PREPA Bondholders' motion seeking to lift the PROMESA's law's stay. In her determination, Judge Swain concluded that the Authority Bondholders failed to demonstrate cause for lifting the automatic stay that would have allowed the Authority Bondholders to seek the appointment of a receiver for the Authority. Judge Swain found that relief sought by the Bondholders, which was expressly designed to facilitate an increase in electricity rates, would run counter to PROMESA's designation of the Authority as the sole entity empowered to develop and propose a plan of adjustment. The Ad Hoc Group of Authority Bondholders appealed Judge Swain's determination.

On August 8, 2018 the U.S. Court of Appeals for the First Circuit vacated Judge Swain's order denying the stay relief motion. The First Circuit concluded that PROMESA did not preclude the district court from granting the movants' request for relief from the automatic stay to commence an action against the Authority to enforce their statutory right to have a receiver appointed. The Circuit Court remanded the matter back to the Title III court for further proceedings consistent with its opinion.

- Proceedings Seeking to Dismiss the Title III Petitions

There have been several motions filed by certain of the Authority's bondholders, bond insurance companies and by the Union de Trabajadores de la Industria Eléctrica y Riego ("UTIER") claiming the dismissal of the Authority's Title III petition, and that the Financial Oversight and Management Board's decision be declared null. All such motions have been denied and dismissed by the Federal Judge presiding the Authority's Title III petition.

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Key Legislation After the Enactment of PROMESA

Act 2-2017

Act No. 2 of January 18, 2017 (“Act 2-2017”) was enacted to repeal and replace the sections under the Moratorium Act that established the Puerto Rico Fiscal Agency and Financial Advisory Authority (“FAFAA”) and its powers and responsibilities. Act 2-2017 expanded FAFAA’s powers so that it has the sole responsibility to renegotiate, to restructure and to reach agreements with creditors on all or part of the public debt or any other debt issued by any Commonwealth entity. In addition, FAFAA is the entity in charge of the collaboration, communication and cooperation efforts between the Commonwealth and the Financial Oversight and Management Board under PROMESA. In essence, Act 2-2017 established FAFAA as the Commonwealth entity responsible for carrying out the roles inherited from the GDB along with additional duties and powers.

FAFAA issued Administrative Order (“AO”) 2017-01, which ordered a freeze on disbursing approximately \$1.8 billion in special legislative appropriations as well as a freeze in processing tax credits that have not yet been approved by the Treasury Department.

Act 5-2017

On January 29, 2017, Governor signed into law Act No. 5 of 2017, known as the *Puerto Rico Fiscal Responsibility and Financial Emergency Act* (“Act 5-2017”), which amended and repealed certain provisions of the Moratorium Act. Act 5-2017 maintained the moratorium on debt payment existing under the Moratorium Act; however, it allowed the Commonwealth to segregate funds that would eventually be used to fund the payment of public debt.

Sections 201 and 203 of Act 5-2017 state that the Governor will pay debt service as long as the Commonwealth could continue to fund essential services, such as the health, safety, and wellbeing of the people of Puerto Rico, including providing for their education and assistance to residents. Act 5-2017 also maintained most of the prohibitions existing under the Moratorium Act regarding loan disbursements by GDB and most of the procedures with respect to governmental withdrawals, payments, and transfer requests in respect of funds held on deposit at GDB. Act 5-2017 continued to declare the Commonwealth to be in a state of emergency and increased the Governor’s powers to manage the Commonwealth’s finances. Some of these additional powers included:

- Exercising receivership powers to rectify the financial emergency declared by the Moratorium Act and Act 5-2017, which may include, among other actions, limiting expenditures of appropriated funds, issuing executive orders regarding the disbursement or disposition of funds held by GDB, accepting or rejecting any executory contracts, approving or disapproving of any debt obligation plans, reviewing and approving of payrolls or other claims against the Commonwealth before payment, and appointing and removing the heads of Commonwealth entities within the Executive Branch that are employees of trust and confidence,

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- Exercising general supervisory control over the functions and activities of all government entities within the Executive Branch,
- Initiating court proceedings in the name of the Commonwealth to enforce compliance with any constitutional mandate or requirement of Act 5-2017,
- Issuing executive orders to implement and enforce compliance with Act 5-2017, and
- Hiring of or contracting with government workers or professional persons who would not be subject to certain laws, as defined.

The emergency period under Act 5-2017 was set to expire on May 1, 2017 to coincide with the expiration of the temporary stay under PROMESA section 405 (as discussed above), unless extended by an additional three months by executive order.

On April 30, 2017, the Governor issued executive order OE-2017-031, which extended to Act 5-2017 emergency period to August 1, 2017. On July 19, 2017, the Legislative Assembly enacted Act No. 46-2017 ("Act 46-2017"), which further extended the Act 5-2017 emergency period through December 31, 2017. Act 46-2017 allowed the Governor to sign executive orders to extend the emergency period for successive periods of six months as long as the Financial Oversight and Management Board remains established for Puerto Rico under PROMESA.

Act 120-2018 - Puerto Rico Electric System Transformation Act

Act No. 120-2018 authorized the required legal framework for the transformation of the Authority via a series of Public-Private Partnerships, to be made in accordance with the framework set forth in the Public-Private Partnership Act of 2009. The Act allows for the sale of assets related to generation and the transfer or delegation of any of PREPA's operations, functions or services. The Act modifies the existing regulatory structure and establishes a working group to design a new regulatory framework and energy public policy for a private sector-based energy system

Act 17-2019 - Puerto Rico Energy Public Policy Act

On April 11, 2019 the Governor signed Act 17-2019 to establish public policy and the regulatory framework for Puerto Rico's energy sector and sets the path for its transformation.

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The Authority's 10 Year Fiscal Plan

On March 13, 2017, the Authority presented its 10-year fiscal plan to the Financial Oversight and Management Board. The Authority commits to fiscal responsibility and implements infrastructure modernization, public-private partnerships, targeted expenditure reductions/efficiencies (operational and other) and specific revenue enhancements. On April 28, 2017, the Financial Oversight and Management Board approved the 10-year fiscal plan for the Authority, subject to certain amendments. For fiscal year 2018, the Authority's fiscal plan submitted to the AAFAF suffered changes related to the projected impacts of filing for Title III, a petition for relief protection and storm recovery. In light of Hurricane María, the Financial Oversight and Management Board required that all new fiscal plans take into consideration the revised economic outlook for Puerto Rico. On April 19, 2018, the Financial Oversight and Management Board certified the Fiscal Year 2018 fiscal plan for the Authority. On August 1, 2018, the Financial Oversight and Management Board recertified an amended FY18 fiscal plan for the Authority. The amended plan included updates to the FY19 budget revenue, revised fuel cost projections, and changes to timelines and target dates based on the most recent available information.

Forbearance Agreements

On August 14, 2014, the Authority entered into certain forbearance agreements (collectively, the "Forbearance Agreements") with certain insurers (the "Monoline Bond Insurers"), beneficiary owners of Power Revenue Bonds (the "Ad Hoc Group of Bondholders"), banks that provide fuel lines of credit (collectively, the "Forbearing Lenders"), and the GDB (collectively, the "Forbearing Creditors"). As provided in the Forbearance Agreements, the Forbearing Creditors agreed not to exercise certain rights and remedies under their financing agreements. The Authority also agreed to prepare a new business plan, "13 week" cash flows, and a recovery plan that would be acceptable to the Forbearing Creditors.

The Forbearance Agreements expired on November 5, 2015, but the agreement of the Forbearing Creditors to refrain from exercising certain rights and remedies was extended under the 2016 RSA (as defined and discussed below).

Under the Forbearance Agreements, as extended and continued under the 2016 RSA, the Authority's obligations to pay any and all principal and interest payments on the Power Revenue Bonds continued. The Forbearing Bondholders consented to an amendment to the Trust Agreement (the "Trust Agreement Amendment") permitting the Authority not to make transfers to the Revenue Fund or the Sinking Fund pursuant to sections 506 and 507 of the Trust Agreement while the Trust Agreement Amendment, as extended and continued under the 2016 RSA, remained in effect. The Authority has not made monthly deposits into the Sinking Fund through January 2017, and then defaulted on the payments due on July 3, 2017 and January 2, 2018, shortly before and after the commencement of the Authority's Title III case.

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Under the Forbearance Agreements, as extended and continued under the 2016 RSA, the Authority was also permitted to delay making certain payments that became due to the Fuel Line Lenders in July and August 2014.

In order to address the Authority's liquidity challenges, the Trust Agreement Amendment permitted the Authority to use approximately \$280 million held in its construction fund for payment of current expenses in addition to capital improvements. The Amendment also provided for an increase in the thresholds required for the exercise of remedies under the Trust Agreement. In connection with the continued implementation of the 2016 RSA, the Trust Agreement was again amended to allow for the issuance of \$130.7 million in bonds to the Monoline Bond Insurers that would mature on January 1, 2016.

Also on January 4, 2016, the Authority paid \$198 million, to satisfy the interest payments on its other outstanding Bonds due on that date.

On January 3, 2017, the Authority paid \$194.4 million, to satisfy the interest payments on its other outstanding Bonds due on that date. This payment was funded with from the Authority's General Fund.

The Authority did not make the principal and interest payments due on the Bonds on July 3, 2017.

Agreements in Principle with Certain Creditors

On September 2, 2015, the Authority announced an agreement in principle regarding the economic terms of a restructuring with the Ad Hoc Group of Bondholders that were Forbearing Bondholders (the "Ad Hoc Group Agreement") and which group held, at that time, approximately 35% in principal amount of the outstanding Bonds, which agreement was incorporated into the 2016 RSA. On September 22, 2015, the Authority announced an agreement in principle regarding economic terms with its Forbearing Lenders (the "Fuel Line Agreement").

Under the extensions to the Forbearance Agreements with the Forbearing Lenders executed on September 22, 2015, the Authority agreed to work collaboratively and in good faith with the Forbearing Lenders to reach agreement on a recovery plan incorporating these terms. The Fuel Line Agreement was included in the 2016 RSA.

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2016 Restructuring Support Agreement

On November 5, 2015, the Authority announced its entry into a restructuring support agreement (the "Initial RSA") with both the Ad Hoc Group (representing at that time approximately 40% in principal amount of the outstanding Bonds) and the Forbearing Lenders setting forth the agreed upon terms of the Authority's recovery plan, which terms were amended to extend the milestone dates therein on numerous occasions. On December 23, 2015, certain of the Monoline Bond Insurers along with the Ad Hoc Group (representing together at that time approximately 66% in principal amount of the outstanding Bonds), the Forbearing Lenders and GDB (the "Supporting Creditors"), all signed an amended and restated version of the Initial RSA (the "A&R RSA").

On January 23, 2016, the A&R RSA terminated when the PREPA Revitalization Act was not enacted into law and the Ad Hoc Group did not agree to the Authority's request to extend the related milestone. The Authority continued to engage in discussions with the Ad Hoc Group and the other Supporting Creditors regarding a potential extension of the A&R RSA.

On January 23, 2016, certain of the Forbearing Lenders agreed to enter into a short form forbearance agreement by which they agreed to forbear from exercising enforcement rights against the Authority under the applicable fuel line agreements through February 12, 2016.

On January 27, 2016, the Authority and the Supporting Creditors executed a revised restructuring support agreement (the "2016 RSA") that was substantially the same as the A&R RSA, with minor adjustments to address delays in legislative consideration of the PREPA Revitalization Act.

Starting on June 29, 2016, the Authority and the Supporting Creditors executed three supplements to the 2016 RSA that (i) extended the December 15, 2016 termination date, (ii) revised certain milestone dates, (iii) reduced forbearance fees, and (iv) added a new milestone for reaching an agreement on amendments to the RSA necessary to implement the transactions contemplated therein under a mechanism agreeable to the parties on or before January 31, 2017 (the "Implementation Milestone").

On January 27, 2017, FAFAA advised the Authority that pursuant to Act 2-2017 it assumed all responsibilities for negotiations with the Authority's creditors and requested that the Authority agree to extend the Implementation Milestone to provide FAFAA additional time to review the terms and conditions of the 2016 RSA.

Thereafter, the parties to the 2016 RSA entered into 15 additional supplements that ultimately extended the termination date and Implementation Milestone to June 28, 2017. However, the RSA was subject to the approval of the FOMB under the PROMESA Act, and the FOMB declined to approve the RSA on June 27, 2017. As a result, the RSA terminated by its own terms on June 29, 2017.

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2018 Preliminary Restructuring Support Agreement

On July 30, 2018, (i) the Authority, (ii) AAFAF, in its capacity as fiscal agent and financial advisor the Authority, (iii) the Financial Oversight and Management Board for Puerto Rico ("FOMB") and (iv) members of the Ad Hoc Group of the Authority's Bondholders (collectively the "Ad Hoc Group"), entered into a preliminary restructuring support agreement (the "RSA") and associated term sheet (the "Term Sheet").

On May 3, 2019, the Governor of Puerto Rico announced that the FOMB, AAFAF and the Authority, reached a Definitive Restructuring Agreement ("Agreement") with a substantial portion of the Authority's bondholders.

Under the Agreement, the bondholders will exchange their existing PREPA bonds for two types of new securitization bonds. The Series A bonds will have approximately 67.5% of the value of the existing bonds, while the Series B bonds will be "growth bonds" that will be linked to the economic recovery of Puerto Rico.

The repayment of the Series B bonds is contingent to the demand for electricity and the repayment of the Series A bonds. It is possible that the Series B bonds do not receive any repayment if the electricity demand is lower than projected in the fiscal plan, and said bonds could be paid in full if the electricity demand is higher than projected.

The terms of the Agreement also establish that the repayment of the bonds will be backed by a fixed transition charge, subject to a predetermined maximum, that does not vary with the fluctuation in sales of PREPA.

The terms of the Agreement require the approval of legislation in the Legislative Assembly of Puerto Rico and will be subject to the approval of the Federal Court in the judicial process of PREPA under Title III of PROMESA.

Financial Oversight and Management Board Actions

The Financial Oversight and Management Board ultimately declined to approve the 2016 Restructuring Support Agreement ("RSA") on June 27, 2017, and the 2016 RSA expired and terminated by its terms on June 29, 2017. On June 30, 2017, the Governor submitted a letter to the Financial Oversight and Management Board stating that the Authority desired to effect a plan to adjust its debts under Title III of PROMESA, as a result of the termination of the 2016 RSA and the lack of a stay under PROMESA. On July 2, 2017, the Financial Oversight and Management Board filed a petition under Title III of PROMESA in the United States District Court for the District of Puerto Rico, commencing a Title III case for the Authority.

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Liabilities Subject to Adjustment

Unsecured obligations owed by the Authority at July 2, 2017 are subject to adjustment in the Title III process. Liabilities subject to adjustment include the following (in thousands):

<u>Obligations subject to adjustment</u>	<u>Balance as of July 2, 2017</u>
Power revenue bonds	\$ 8,258,612
Lines of credit and notes payables	737,587
Trade Vendors and supplier claims	186,920
Contributions in lieu of taxes claims	<u>1,276,773</u>
	<u>\$ 10,459,892</u>

Obligations subject to adjustment with undetermined amounts as of July 2, 2017 were:

- SWAP claims
- Employee claims
- Litigation and property damage claims
- Environmental claims
- Union grievance claims

Amounts that the Authority recorded as liabilities subject to adjustment are in many instances different from amounts filed by the creditors. Differences between amounts scheduled by the Authority and claims filed by the creditors are being investigated and will be resolved in connection with the claims reconciliation process. Until the process is complete, the ultimate number and amount of allowable claims cannot be ascertained.

In this regard, it should be noted that the claims reconciliation process may result in adjustments to current estimates of allowable claims. Although the Authority currently believes the liability amounts are fairly represented, the ultimate resolution of these claims will be based upon the final plan of adjustment confirmed by the United States District Court for the District of Puerto Rico.

Bond Ratings Downgrades

On July 6, 2017, Moody's downgraded its rating for the Authority's bonds to Ca from Caa3. This latest downgrade reflects the Authority having commenced a proceeding under Title III of PROMESA. At the same date, Fitch also downgraded its rating for the Authority's bonds from C to D. On February 9, 2018, S&P withdrew its D rating and is now not rated (NR) the Authority.

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Announcement of Privatization of the Authority

On January 22, 2018, the Governor announced that the government will begin the transformation of the Authority. Pursuant to the Fiscal Plan certified August 1, 2018, the transformation and privatization process will take several months in preparation, market process and approvals. There will be a Working Group established between the Governor, the Financial Oversight and Management Board and advisory teams to coordinate and lead the transaction process for the sale of power generation assets and a concession for Transmission and Distribution assets and activities. On June 20, 2018, the Governor signed Act 120, which establishes a legal framework for the disposition, transfer and sale of the Authority's assets, operations, functions and services.

On October 31, 2018, the Governor announced the request for qualifications ("RFQ") from interested entities in managing and operating the Authority's electric power transmission and distribution system, pursuant to a long-term public-private partnership agreement. The objective of the RFQ is to identify qualified respondents that are eligible to receive Request for Proposals ("RFP") from the Puerto Rico Public-Private Partnerships Authority ("P3 Authority").

On April 16, 2019, the P3 Authority, in collaboration with the Authority, requested Statements of Qualifications ("SOQs") from companies and consortia interested in rehabilitating, upgrading, managing and operating sixteen hydroelectric generating units and their respective turbines, switchyards, dams and reservoirs at nine facilities (each a Project Hydropower Facility and together, the Project Hydropower System) located throughout the island of Puerto Rico, including the administration of federal disaster recovery funding, if any, pursuant to a long-term contract. Additional facilities may be included. Responses to the SOQs were due by June 3, 2019. As of June 28, 2019, the qualified respondents are engaged with the P3 Authority in a Q&A process.

Superpriority Post-Petition Revolving Credit Loan Agreement

On February 22, 2018, the Authority and the Commonwealth entered into a Revolving Credit Loan Agreement, in which the Commonwealth agreed to make a revolving loan to the Authority consisting of a superpriority post-petition credit facility in an aggregate principal amount not to exceed \$300 million, available to the Authority until June 30, 2018, unless extended by necessary governmental action by the Commonwealth. The Revolving Credit Loan shall bear 5% interest, provided that, in the event the Commonwealth funds or refinances the Revolving Credit Loan with the proceeds of a Commonwealth Financing, the interest rate on the such funded or refinanced Revolving Credit Loan shall automatically accrue interest at the rate equal to the interest rate on the Revolving Credit Loan not funded or refinanced with any Commonwealth Financing. On March 8, 2019, the revolving credit facility was paid off by the Authority.

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Hurricane Irma's Impact in Customer Power

On September 5, 2017, the Authority declared an emergency to address expected operational challenges due to Hurricane Irma approaching Puerto Rico. On September 6, 2017, Hurricane Irma passed just north of San Juan, Puerto Rico. As a result of Hurricane Irma, customer power outages reached their highest point on September 7, 2017 with approximately 1.1 million (or 75 percent) of customers without power.

Hurricane María's Impact on Power Grid

As a result of Hurricane María, power outages reached its highest point on September 20, 2017 with 1.4 million (or 100 percent) of customers without power. The Authority is still assessing the extent of damages and quantifying the costs of repairing and rebuilding the system. Additionally, the Authority is working closely with FEMA to ensure adequate documentation of the costs of the emergency and repairs. The Authority has submitted and is currently working in a property insurance claim to its insurers.

Hurricanes Irma and María Impact on Electric System and Grid

The Authority's electric system and grid sustained significant damage as a result of Hurricanes Irma and Maria. The Authority requested FEMA and other critical stakeholders to be present at the Authority's headquarters on a regular basis to be part of an integrated working group to expedite execution of the Authority's emergency response plan.

Delegation of Powers to the Authority's Governing Board

On March 22, 2018, the Governor of Puerto Rico issued Executive Order OE-2018-012 in which the Authority's Governing Board was appointed receiver of the Employees' Retirement System (the "System") to: i) take those actions and decisions that are necessary to immediately finalize, evaluate, approve and/or sign the necessary documents (including the representation letter from the System's management) for the final publication of the actuarial reports and audited financial statements of the System for the corresponding fiscal years, up to and including fiscal year 2017, and ii) deliver, or cause the delivery to AAFAF of any information of the Retirement System necessary or convenient for the elaboration of the Authority's revised Fiscal Plan or budget for fiscal year 2019. This designation will be in effect until: i) the actuarial reports and audited financial statements of the Retirement System are issued for the corresponding fiscal years, up to and including fiscal year 2017, ii) the Financial Oversight and Management Board ("FOMB") certifies a received Fiscal Plan for the Authority and iii) the FOMB certifies a budget for the Authority for fiscal year 2019. The System's Board of Trustees will continue to exercise all other functions that correspond to it in the daily administration of the Retirement System, provided that, in no way may it directly or indirectly prevent, or allow the prevention through third parties, including contractors, of the approval and/or publication by the Authority's Governing Board of the actuarial reports and financial statements of the Retirement System.

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On March 27, 2018, the ERS plaintiffs filed a Civil Action in San Juan Superior Court. It seeks, among other relief, declaratory and injunctive relief providing that (1) the Authority's Employees Retirement System is a trust separate and independent of the Authority and the Commonwealth, and (2) the Executive Order interferes with the independence and powers of the Retirement System and is null and void. On April 27, 2018, the Financial Oversight and Management Board filed a notice of removal of the Civil Action to the Title III Court. On May 28, 2018, the ERS plaintiffs filed a motion to remand the Civil Action to the San Juan Superior Court.

On February 6, 2019, after obtaining leave from the Court, Plaintiffs filed an amended complaint which included, as additional defendants, all members of Authority's Governing Board in their official capacities. On April 3, 2019, the Court granted defendants, including Authority and the members of its Governing Board, until April 25, 2019 to answer or otherwise respond to the amended complaint.

Sale of PREPA Holdings subsidiaries

In accordance with the Fiscal Plan submitted to the Financial Oversight and Management Board, the Authority commenced a process to sell the assets and operations of PREPA Holdings, LLC. On December 20, 2017, the Authority's Governing Board authorized the PREPA Holdings, LLC, to hire consultants to examine the potential sale of the subsidiaries' membership interest, including PREPA.Net. On January 30, 2019, the Authority's Governing Board resolved that the Authority's Governing Board shall retain total control of any sale, disposition, concession or related transactions regarding PREPA Holdings, LLC, and its subsidiaries. On March 27, 2019, PREPA's Governing Board resolved that PREPA.Net Management will cease its efforts to seek interested buyers for the PREPA Holdings, LLC, because, among other considerations, PREPA.Net is vital to the T&D electrical network.

Supply of Natural Gas and Conversion of Units 5 and 6 of the San Juan Combined Cycle Power Plant

On March 5, 2019, after a competitive request for proposal ("RFP") bid process, the Authority announced that it entered into a contract with NFEnergy LLC, the Puerto Rico subsidiary of New Fortress Energy LLC for the supply of natural gas and conversion of Units 5 and 6 of the San Juan Combined Cycle Power Plant. The initial term of the contract is five years, with the Authority having the options to extend it for three additional five-year periods.

Partial payment to the Authority from GDB Public Entity Trust ("PET")

On October 5, 2018, GDB, AAFAF, the Financial Oversight and Management Board for Puerto Rico and the Official Committee of Unsecured Creditors (the "Committee") entered into a stipulation (the "Stipulation") resolving certain litigation that had been commenced by the Committee challenging GDB's restructuring proceeding under Title VI of PROMESA (the "GDB Restructuring"). The U.S. District Court for the District of Puerto Rico entered an order on the Stipulation on October 9, 2018.

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FOR THE YEAR ENDED JUNE 30, 2017

GDB, as trustee of the PET, transferred \$15,302,219 to the Authority, corresponding to the amount allocated to the Authority on account of its claim against the PET.

U.S. Internal Revenue Service Examinations

The United States Internal Revenue Service (the "IRS") issued several letters dated from February 7, 2019 to March 28, 2019 to the Authority, to inform that the IRS is conducting certain investigations. The investigations are related to certain Forms 8038-CP Return for Credit Payments to Issuers of Qualified Bonds, as defined by the IRS, and Series YY and EEE bond issuances.

The Authority intends to respond to all correspondences from the IRS and intends to continue to cooperate with the IRS in connection with the above referenced examinations and are working with their representatives to respond to these IRS examinations in a timely manner.

REQUIRED SUPPLEMENTARY INFORMATION

PUERTO RICO ELECTRIC POWER AUTHORITY
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SCHEDULE I -SUPPLEMENTARY SCHEDULE OF FUNDING PROGRESS -
POST-EMPLOYMENT HEALTH PLAN (IN MILLIONS)
FOR THE YEAR ENDED JUNE 30, 2017

<u>Actuarial Valuation Date</u>	<u>Unfunded Actuarial Accrued Liability (UAAL) (a)</u>	<u>Covered Payroll (b)</u>	<u>UAAL Percentage of Covered Payroll (a)/(b)</u>
<u>Post-Employment Health Plan</u>			
07/01/2014	\$ 408	\$ 305	133 %
07/01/2012	\$ 378	\$ 364	104 %
07/01/2010	\$ 408	\$ 357	114 %

**Post-Employment Health Plan valuation performed every two years, as required by the GASB.*

***During the actuarial valuation dates presented above the Post-Employment Health Plan did not have any assets to be considered.*

PUERTO RICO ELECTRIC POWER AUTHORITY
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SCHEDULE II - SCHEDULE OF CHANGES IN THE AUTHORITY'S NET PENSION LIABILITY
AND RELATED RATIOS (IN THOUSANDS) (PRESENTED THREE YEARS ONLY)
FOR THE YEAR ENDED JUNE 30, 2017

	For measurement period ended June 30,		
	2016	2015	2014
Total pension liability			
Service cost	\$ 79,927	\$ 86,627	\$ 38,420
Interest on total pension liability	209,459	205,706	249,451
Difference between expected and actual experience	(19,815)	11,763	47,103
Changes in assumptions	947,510	(60,243)	1,796,904
Benefits payments	(254,624)	(279,479)	(216,811)
Refunds of contributions	<u>(1,200)</u>	<u>(1,126)</u>	<u>(795)</u>
Net change in total pension liability	961,257	(36,752)	1,914,272
Total pension liability - beginning	<u>4,921,032</u>	<u>4,957,784</u>	<u>3,043,512</u>
Total pension liability - ending (a)	<u>\$ 5,882,289</u>	<u>\$4,921,032</u>	<u>\$4,957,784</u>
Plan Fiduciary Net Position			
Adjustment to beginning Plan net position	-	1,672	-
Contributions-employer	113,384	99,179	100,145
Contributions-member	26,470	28,242	36,871
Net investment income	18,700	69,991	179,191
Benefit payments	(254,625)	(279,479)	(216,811)
Administrative expense	(385)	(598)	(348)
Refunds of employee contributions	(1,200)	(1,126)	(795)
Transfers from other systems	309	437	1,275
Impairment loss on deposits held in GDB	<u>(4,129)</u>	<u>-</u>	<u>-</u>
Net change in plan fiduciary net position	<u>(101,476)</u>	<u>(81,682)</u>	<u>99,528</u>
Plan fiduciary net position-beginning	<u>1,317,230</u>	<u>1,398,912</u>	<u>1,299,384</u>
Plan fiduciary net position-ending (b)	<u>\$ 1,215,754</u>	<u>\$1,317,230</u>	<u>\$1,398,912</u>
Net pension liability-ending (a)-(b)	<u>\$ 4,666,535</u>	<u>\$3,603,802</u>	<u>\$3,558,872</u>
Covered-Employee Payroll	\$ 270,705	\$ 287,143	\$ 341,910
Plan Fiduciary Net Position as a percentage of the Total Pension Liability	20.67 %	26.77 %	28.22 %
Net Position Liability as a percentage of Covered-Employee Payroll	1,724 %	1,255 %	1,041 %

PUERTO RICO ELECTRIC POWER AUTHORITY
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NOTES TO THE SCHEDULE OF CHANGES IN THE AUTHORITY'S NET PENSION
LIABILITY AND RELATED RATIOS
AS OF JUNE 30, 2017 AND FOR THE YEAR ENDED

Benefit Changes

Benefit changes, which are reflected immediately in pension expense, can be positive, if there is a benefit improvement for existing System members, or negative if there is a benefit reduction. For the year ended June 30, 2016, there were no benefit changes to be recognized.

Changes of Assumptions

These were the changes in assumptions during the measurement period ended June 30, 2017:

- The discount rate used to determine the TPL decreased from 4.37% to 2.93% since the prior measurement date.
- Assumed rates of retirement for members hired before January 1, 1993 have been adjusted.
- Assumed rates of disability retirements have been adjusted.
- Assumed rates of active mortality have been updated to the RP-2014 Mortality Table projected to 2018 using Scale BB, set back one year for males.
- Assumed rates of disabled annuitant mortality have been updated to the RP-2014 Disabled Annuitant Mortality Table projected to 2018 using scale BB.
- Assumed rates of healthy annuitant mortality have been updated to the RP-2014 Mortality Table projected to 2018 using Scale BB, set back on year for males.
- The merit component of the salary scale was adjusted.
- Assumed rate of wage inflation was reduced from 3.50% to 2.50%.
- Assumed rate of price inflation was reduced from 2.50% to 2.25%.
- The assumed rate of return on assets was reduced from 8.25% to 5.75%.
- The payroll growth assumption for amortizing the unfunded actuarial accrued liability as a level percentage of payroll was reduced from 3.50% to 0.00%.

Any change in Total Pension Liability due to changes in actuarial assumption, recognition of the change would be spread over the remaining life of the System membership.

PUERTO RICO ELECTRIC POWER AUTHORITY
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SCHEDULE III - SCHEDULE OF EMPLOYER CONTRIBUTIONS - PENSION PLAN
(IN THOUSANDS)
FOR THE YEAR ENDED JUNE 30, 2017

Fiscal Year Ended June 30,	Actuarially Determined Employer Contribution	Actual Employer Contributions	Actual Employer Deficiency/ (Excess)	Covered Employee Payroll	Actual Contributions as a percentage of Covered employee payroll
2017	\$ 147,607	\$ 120,272	\$ 27,281	\$ 258,210	46.40 %
2016	141,481	113,384	28,097	270,704	41.88 %
2015	99,179	99,179	-	287,143	34.54 %
2014	100,145	100,145	-	341,910	29.29 %
2013	89,481	89,481	-	347,094	25.78 %
2012	85,361	85,361	-	357,758	23.86 %
2011	85,313	85,313	-	358,458	23.80 %
2010	69,926	69,926	-	354,955	19.70 %
2009	78,490	78,490	-	372,344	21.08 %
2008	75,768	75,768	-	348,361	21.75 %

Notes to Schedule of Employer Contributions

Valuation Date

Actuarially determined contributions rates are calculated as of June 30, one year prior to the end of the fiscal years in which contributions are reported. Method and assumptions used to determine contribution rates for the year ended June 30, 2017 and related information for the Plan and supplemental benefits follows:

Pension Plan	
Actuarial cost method	Individual Entry Age Normal
Amortization method	Dollar amount with 3.5% annual increases, closed
Remaining amortization period	24 years
Asset valuation method	5-year smoothed market
Inflation	2.5 percent
Salary increases	2.5 to 7.25 percent, including inflation
Investment rate of return	5.75 percent, net of System Investment expense, and including inflation

**SUPPLEMENTAL SCHEDULES
(UNAUDITED)**

PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
SCHEDULE IV - SOURCES AND DISPOSITION OF NET REVENUES UNDER THE PROVISIONS
OF THE 1974 AGREEMENT STATEMENTS OF REVENUES, EXPENSES AND CHANGES
IN NET POSITION AND RECONCILIATION OF NET INCOME (IN THOUSANDS)
(UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2017

	1974 Trust Agreement	2017 Statement of Revenues, Expenses and Changes in Net Position (Deficit) (GAAP)	Reconciliation of Net Income
Reconciliation of components of net income:			
Revenues:			
Operating revenues	\$ 3,298,438	\$ 3,298,223	
Other operating revenues	23,371	37,117	
Other	9,352	-	
1974 agreement construction fund investment income and gain on sale of other properties	(453)	7,317	
	<u>3,330,708</u>	<u>3,342,657</u>	\$ 11,949
Current expenses:			
As shown	<u>2,579,695</u>	<u>2,606,210</u>	<u>(26,515)</u>
Total as defined	<u>2,579,695</u>	2,606,210	
Net revenues, as defined	<u>\$ 751,013</u>		
Depreciation		519,406	(519,406)
Pension expense		727,777	(727,777)
Other post-employment benefit		6,760	(6,760)
Disposition of Revenues:			
(not classified in order of payment)			
Interest of debt	\$ 430,652	430,652	
Interest on general obligation notes	52,879	53,736	
Amortization of debt discount, financing expenses	-	(9,103)	
Amortization of bond defeasance	-	7,572	
	<u>483,531</u>	<u>482,857</u>	674
Power revenue bonds:			
Principal	224,035	-	224,035
Balance available for capital improvement and other needs	43,447	-	43,447
Contribution in lieu of taxes and other	-	178,003	(178,003)
Total expenses (GAAP)		<u>4,521,013</u>	
Net revenue, as defined	<u>751,013</u>		
Net loss		<u>\$ (1,178,356)</u>	<u>\$ (1,178,356)</u>

See notes to the Schedules IV-VIII

PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
SCHEDULE V -SUPPLEMENTAL SCHEDULE OF SOURCES AND DISPOSITION OF NET
REVENUES UNDER THE PROVISIONS OF THE 1974 AGREEMENT (IN THOUSANDS)
(UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2017

Sources of Net Revenues:

Revenues:

Electric revenues	\$ 3,298,438
Other operating revenues	23,371
Other (principally interest)	<u>8,899</u>
Total revenues	3,330,708

Current expenses:

Operations:

Fuel	1,217,525
Purchased Power	728,872
Maintenance	163,747
Administrative and general	140,325
Transmission and distribution	163,953
Customer accounting and collections	112,946
Other production	<u>52,327</u>

Total current expenses	<u>2,579,695</u>
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Net revenues, as defined	<u>\$ 751,013</u>
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Disposition of Net Revenues:

Revenue fund:

Power revenue bonds - sinking fund requirements:

Interest	\$ 430,652
Principal	224,035
Balance available for capital improvement and other needs	<u>43,447</u>

Total revenue fund	698,134
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General obligation notes:

Interest	<u>52,879</u>
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Net revenues, as defined	<u>\$ 751,013</u>
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See notes to the Schedules IV-VIII

PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
SCHEDULE VI - SUPPLEMENTAL SCHEDULE OF FUNDS UNDER THE PROVISIONS
OF THE 1974 AGREEMENT (IN THOUSANDS) (UNAUDITED)
JUNE 30, 2017

	2017			
	Held by Authority		Restricted Deposits with Trustee	
	Total	Other Assets	Other Assets	Non-Current Assets
By Account:				
1974 Agreement (restricted):				
Sinking Fund - Bond Services	\$ 3,388	\$ -	\$ 3,388	\$ -
Reserve Account in the sinking fund	5,417	-	5,417	-
Self-Insurance Fund	-	-	-	-
Sinking Fund - Capitalized Interest	-	-	-	-
Reserve Maintenance Fund	16,150	-	16,150	-
Other Restricted Fund	1,934	-	1,934	-
Construction Fund:				
Other	23,866	-	23,866	-
PREPA Client Fund	3,195	-	3,195	-
General purpose (unrestricted)				
General (excluding PREPA Net)	527,658	527,658	-	-
Working funds	5,285	5,285	-	-
Total	<u>\$ 586,893</u>	<u>\$ 532,943</u>	<u>\$ 53,950</u>	<u>\$ -</u>
By Type of Assets Held:				
Working funds	\$ 5,208	\$ 5,208	\$ -	\$ -
PREPA Client Fund	3,195	-	3,195	-
Cash in bank and time deposits (by depository institutions):				
Banco Popular de Puerto Rico	43,579	38,690	4,889	-
Citibank, N.A.	497,731	461,631	36,100	-
US Bank	8,873	-	8,873	-
US Bank - Service Bond	-	-	-	-
Oriental Bank	17,148	16,255	893	-
First Bank, San Juan, PR	793	793	-	-
Banco Santander, San Juan, PR	4,747	4,747	-	-
Scotiabank	5,619	5,619	-	-
Total	<u>\$ 586,893</u>	<u>\$ 532,943</u>	<u>\$ 53,950</u>	<u>\$ -</u>

See notes to the Schedules IV-VIII

PUERTO RICO ELECTRIC POWER AUTHORITY

(A Component Unit of the Commonwealth of Puerto Rico)

**SCHEDULE VII -SUPPLEMENTAL SCHEDULE OF CHANGES IN CASH AND INVESTMENTS BY FUNDS (IN THOUSANDS) (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2017**

	General Purpose Fund					Sinking Fund			Other Restricted Funds				
	Total	General Fund	Revenue Fund	Working Fund	Reserve for Current Expenses Fund	Interest 1974 Agreement	Principal 1974 Agreement	Reserve Maintenance Agreement	Self Insurance	Construction 1974 Agreement	Reserve Maintenance Fund	Subordinated Obligation Fund	Other Restricted Fund
Balance at June 30, 2016	\$ 434,674	\$ 3,418	\$ 13	\$ 1,350	\$ 302,568	\$ (762)	\$ 787	\$ 6,003	\$ (35)	\$ 100,133	\$ 16,083	\$ -	\$ 5,116
Operations:													
Actual net revenues per Schedule V	751,013	751,013	-	-	-	-	-	-	-	-	-	-	-
Investment income and other	590	-	-	-	-	6	1	-	3	501	67	-	12
Payment of legal expenses from Reserve Account	(210)	-	-	-	-	-	-	(210)	-	-	-	-	-
Funds provided by Irrigation Systems	2,951	2,951	-	-	-	-	-	-	-	-	-	-	-
Interfunds transfers (to Current Expenses Fund)	-	(225,076)	-	-	225,076	-	-	-	-	-	-	-	-
Adjustment to net revenues (Non cash contributed capital)	(5,105)	(5,105)	-	-	-	-	-	-	-	-	-	-	-
Funds used for construction	(171,646)	(90,263)	-	-	-	-	-	-	-	(81,383)	-	-	-
Proceeds from Federal Agencies and Insurance Companies	13,436	13,436	-	-	-	-	-	-	-	-	-	-	-
Financing:													
Proceeds from new bond issues, net of original discounts	23,632	23,632	-	-	-	-	-	-	-	-	-	-	-
Sinking Fund transfers (Principal and Interest)	-	(218,492)	-	-	-	218,492	-	-	-	-	-	-	-
Proceeds from notes for working capital	4,614	-	-	-	-	-	-	-	-	4,614	-	-	-
Payments of notes payable	(2,717)	(2,717)	-	-	-	-	-	-	-	-	-	-	-
Payment of interest	(269,955)	(51,463)	-	-	-	(218,492)	-	-	-	-	-	-	-
Other sources from PREPA Holdings, LLC	3,043	3,043	-	-	-	-	-	-	-	-	-	-	-
Changes in assets and liabilities:													
Working funds	195	-	-	195	-	-	-	-	-	-	-	-	-
Accounts receivable (includes non-current)	(162,516)	(162,516)	-	-	-	-	-	-	-	-	-	-	-
Fuel oil	(33,415)	(33,415)	-	-	-	-	-	-	-	-	-	-	-
Materials and supplies	(3,914)	(3,914)	-	-	-	-	-	-	-	-	-	-	-
Prepayments and other	18,905	18,905	-	-	-	-	-	-	-	-	-	-	-
Non-current liabilities, excluding revenue bonds and notes payable	(1,307)	(1,307)	-	-	-	-	-	-	-	-	-	-	-
Accounts payable and accrued liabilities (includes non-current)	(36,188)	(36,188)	-	-	-	-	-	-	-	-	-	-	-
Customer deposits	8,840	8,840	-	-	-	-	-	-	-	-	-	-	-
Total before interfund accounts	574,920	(5,218)	13	1,545	527,644	(756)	788	5,793	(32)	23,865	16,150	-	5,128
Add/(deduct) Interfund Account	11,973	8,960	-	(1)	-	4,144	(788)	(343)	(1)	1	-	-	1
Balance at June 30, 2017	\$ 586,893	\$ 3,742	\$ 13	\$ 1,544	\$ 527,644	\$ 3,388	\$ -	\$ 5,450	\$ (33)	\$ 23,866	\$ 16,150	\$ -	\$ 5,129

See notes to the Schedules IV-VIII

PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
SCHEDULE VIII - SUPPLEMENTARY SCHEDULE OF CHANGES IN LONG-TERM DEBT AND
CURRENT PORTION OF LONG-TERM DEBT (IN THOUSANDS) (UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2017

Long-term debt, excluding current portion:	
Balance at beginning of year	\$ 8,143,319
Transfers to current liabilities:	
Power revenue bonds	(354,704)
Notes payable	<u>(931)</u>
Remainder	7,787,684
New issues:	
Notes payable	<u>4,617</u>
Balance at end of year	<u>\$ 7,792,301</u>
Current portion of long-term debt:	
Balance at beginning of year:	\$ 974,848
Transfer from long-term debt	355,635
Transfer from loss on refinancing - deferred outflows	(7,430)
Payments to bondholders:	
Power revenue	-
Payment of notes payable	(2,714)
Loss on refunding on debt	
Amortization of debt discount	(10,586)
Amortization of loss on refinancing of debt	<u>7,572</u>
Balance at end of year	<u>\$ 1,317,325</u>

See notes to the Schedules IV-VIII

**PUERTO RICO ELECTRIC POWER AUTHORITY
(A Component Unit of the Commonwealth of Puerto Rico)
NOTE TO THE SCHEDULES IV-VIII - INFORMATION REQUIRED BY THE 1974 AGREEMENT
(UNAUDITED)
FOR THE YEAR ENDED JUNE 30, 2017**

BASIS OF PRESENTATION

The Schedules IV - VIII present certain information which is required by the 1974 Agreement. The Net Revenues data, as defined in the 1974 Agreement ("Net Revenues"), presented in Schedules IV and V differ in some important respects from the amounts presented in the basic financial statements which are presented in accordance with accounting principles generally accepted in the United States of America ("GAAP"). Such differences are explained below; Schedule IV also presents a reconciliation of Net Revenues with GAAP.

The most significant differences between Net Revenues and GAAP are the following:

1. Revenues do not include investment income earned in the construction fund
2. Pension expense, other post-employment benefits, depreciation and interest expense on bonds covered by the 1974 Agreement are not included as deductions in calculating Net Revenues;
3. Amortization of debt discount and issuance cost and the allowance for funds used during construction are not considered in the computation in calculating Net Revenues;
4. Contribution in lieu of taxes is not considered a deduction for purposes of Net Revenues;
5. Net Revenues do not include revenues or expenses of the Irrigation Systems.